BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
A La Carte and Themed Tier	)	
Programming and Pricing Options	)	MB Docket No. 04-207
for Programming Distribution on Cable Television	)	
and Direct Broadcast Satellite Systems	)	

REPLY COMMENTS OF COMCAST CORPORATION

Joseph W. Waz, Jr.
COMCAST CORPORATION
1500 Market Street
Philadelphia, PA 19102

James R. Coltharp
COMCAST CORPORATION
2001 Pennsylvania Avenue, N.W.
Suite 500
Washington, D.C. 20006

Thomas R. Nathan
COMCAST CABLE COMMUNICATIONS, INC.
1500 Market Street
Philadelphia, PA 19102

Michael H. Hammer
Ryan G. Wallach
Stephanie L. Podey
WILLKIE FARR & GALLAGHER LLP
1875 K Street, N.W.
Washington, D.C. 20006-1238
Attorneys for Comcast Corporation

August 13, 2004

EXECUTIVE SUMMARY

In the *Notice*, the Commission sought information from the public regarding the effects of mandatory a la carte or themed-tier requirements in two areas of primary importance: *consumer prices* and *program diversity*. In response, nearly every party filing comments agreed with Comcast that such requirements would result in higher prices and fewer program choices for cable and DBS consumers. For example, Discovery Communications estimates that the Discovery Channel would be *12 times more expensive* for consumers in an a la carte environment. Disney says that consumers paid between \$10 and \$16 per month when the Disney Channel was offered a la carte, but now pay the equivalent of \$1.48 per month when it is offered in a tier. A wide range of independent, minority, religious, news, women's, sports, and general entertainment programmers warn that a la carte and themed tier requirements would diminish the diversity of programming that the current market-driven system of cable and DBS tiers makes possible.

It is difficult to imagine a stronger record in opposition to regulations requiring a la carte and themed tiers. It was strengthened further by the witnesses at the July 29, 2004 symposium on a la carte, particularly by the *four independent economists who all advised against any such interference in the market*.

A few commenters propose a la carte or themed tiers as a solution for parents who want to exercise control over what their children watch on television. These commenters largely ignore the fact that cable operators provide technologies that empower parents with *very significant and effective control* over the programming that comes into their homes. In particular, digital cable, which is available today to 97% of Comcast's customers, provides a powerful and economical way for parents to create their own "family tier," or to block programming that they do not want in a number of ways, such as by channel, rating, time, or program title.

Because Comcast listens to its customers and agrees that they should be able to exercise greater control over the programming viewed in their homes, we have taken numerous concrete steps to ensure that parents are aware of the parental control tools, including advertising parental control options on the on-screen program guide, extensively running public service announcements informing parents about their options, upgrading and improving parental control information on our customer websites, setting up a dedicated 800 "help" number, and providing parental control information in customer welcome kits and monthly bills. All of these parental control tools -- and the information on how to use them -- are available to parents today without having to change any laws or rules. Most importantly, these tools do not have all of the harmful consequences that a la carte and themed tiers would bring to the many niche program services, including high-quality, family-friendly services that consumers enjoy today.

A few commenters advocate a la carte because they believe tiers require them to "subsidize" programming they find objectionable. But economic analysis of tiering proves that customers who prefer only certain services included in a tier do *not* subsidize programming they do not watch, no more so than purchasers of a newspaper "subsidize" columnists they do not read; rather, consumers pay for the *ability* to select the programs they do want to watch from a wide variety of programming available to them. Moving to a la carte or themed tiers would destroy this ability while raising prices for virtually all viewers.

One issue on which critics and proponents of a la carte and themed tiers agree is that any effort to implement a la carte would lead to a massive new set of regulations for the cable and DBS industries. Those who support a la carte have proposed regulations that would: (1) define a la carte and themed tiers and set out the carriage obligations for cable and DBS operators; (2) establish rate regulations to ensure that a la carte and themed tier pricing is "affordable"; (3) establish the terms upon which local broadcasters and broadcast networks would be carried on the basic tier; (4) provide adequate funding for public, educational, and governmental channels; (5) dictate how cable and DBS operators may or may not promote program services depending on the ownership structure of the services; (6) ensure that cable-programmer affiliation contracts are open for public inspection; (7) require cable operators to carry on basic cable all services for which they pay no direct license fee; (8) adopt new regulations for set-top boxes; and (9) both expand and restrict the current retransmission consent rules. There is nothing "voluntary" in any of this -- by merely opening the regulatory door, the proponents of a la carte would invite a whirlwind of new regulations.

As Comcast explained in its initial comments, the government's prior efforts to regulate the pricing and packaging of video programming had long-lasting detrimental effects on the cable industry and consumers alike. The government should not go down that road again, particularly given the competitive state of the MVPD marketplace and the demonstrated harms that such regulation has caused and would cause in the future. The regulations proposed this time are no wiser, and certainly no simpler, than what the government tried before -- and they are far less justified.

Comcast also responds to several specific arguments raised by commenters and shows that:

- Consumers Union's claim that the video distribution marketplace is not competitive is refuted by the facts, including the Commission's previous findings, and the record in the instant proceeding.

- The consumer surveys relied on by Consumers Union are seriously flawed and their results cannot be taken as a meaningful indication of significant consumer demand for a la carte or themed tiers, particularly when their true consequences are understood.

- The interdiction technology proposed by Blonder Tongue Laboratories is not suitable for delivery of video programming on an a la carte or themed tier basis.
- NATOA's assertion -- that a brief effort by cable operators to use a la carte during a period of rate regulation over a decade ago is evidence that a la carte is a workable business model today -- is plainly wrong.

Most important, however, is the fact that the overwhelming number of commenters in this proceeding strongly oppose mandatory a la carte or themed tier requirements. Opponents include civil rights groups, free-market groups, religious organizations, women's groups, state and local elected officials, cable operators, DBS providers, sports interests, and motion picture studios, to name a few. The breadth, depth, and intensity of this opposition is striking, as is the economic record showing the negative consumer effects of such regulatory mandates. We urge the Commission to report to Congress that, for all of these good reasons, a la carte and themed tier regulation is not in the public interest.

TABLE OF CONTENTS

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
A La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems	)	MB Docket No. 04-207

REPLY COMMENTS OF COMCAST CORPORATION

Comcast Corporation ("Comcast") hereby replies to the comments submitted in response to the Commission's request for information and analysis pertaining to a la carte and themed tier pricing options for programming distributed by cable operators and DBS providers.[1] Those comments provide abundant support for the arguments presented in Comcast's initial comments. The record shows that the proposed government intrusion into pricing and packaging practices in the multichannel video marketplace would jeopardize the abundance, breadth, diversity, and value of programming choices that consumers enjoy today.

I. THE VAST MAJORITY OF COMMENTERS AGREE: MANDATORY A LA CARTE OR THEMED TIERS WOULD INCREASE CONSUMER PRICES AND REDUCE DIVERSITY.

A. A La Carte or Themed Tiers Would Increase Consumer Prices.

In the initial round of comments, Comcast and many others explained that mandatory a la carte or themed tiers would in fact *increase* consumers' prices.[2] A la carte and themed tiers

---

1 *In re Comment Requested on A La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems*, Public Notice, MB Docket No. 04-207 (May 25, 2004), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-04-1454A1.pdf.

2 Comcast Comments at 15-29, app. A ¶ 38 ("*Katz Analysis*"); Eternal Word TV Network ("EWTVN") Comments at 2-5; LAtv Holdings ("LAtv") Comments at 1-3; Nat'l Cable &Telecomm. Ass'n ("NCTA") Comments at 28, Attachment A at 32-34 (Booz Allen Hamilton, *The A La Carte Paradox: Higher Consumer Costs*

would reduce a program service's subscribers and viewership (after all, HBO, by far the most successful a la carte service in the history of television, is subscribed to by only 30% of a typical cable system's subscribers) and thereby undermine its ability to generate revenues from both subscription fees and advertising. To make up for these revenue shortfalls, a program service has limited choices -- it must either lower its production costs by reducing quality, increase the rates it charges for advertising, or raise its subscription fees. Reducing quality would harm both programmers and viewers. A programmer would not be able to raise its advertising rate because, in an a la carte world, it would have *fewer* actual and potential viewers. Thus, the programmer's only viable option would be to try to raise its subscription fees. At a time when programming costs represent the single most significant recurring cost for cable and DBS operators, there is no doubt that any increases in subscription fees would be borne by all multichannel video consumers.[3]

The experience of program services that have been offered a la carte show that consumers pay more for a la carte services. For example, Disney says that when it offered The Disney Channel a la carte consumers paid between $10 and $16 per month, but when the service was moved to the expanded basic tier consumers paid an effective price of $1.48 per month.[4]

---

and Reduced Programming Diversity (July 2004)); Scripps Networks ("Scripps") Comments at 19-23; Time Warner Comments at 9-11; Walt Disney ("Disney") Comments at 12-18, Exhibit 1, at 19-20 (Michael G. Baumann & Kent W. Mikkelsen, Economists Inc., *Benefits of Bundling and Costs of Unbundling Cable Networks* (July 15, 2004)).

[3] Moreover, each program service would incur significant additional marketing costs in an a la carte environment, and these costs would also be passed on to cable and DBS subscribers. *See* Disney Comments at 18; Weather Channel Comments at 7-8; MBC Gospel Network ("MBC") Comments at 3-4; Oxygen Media ("Oxygen") Comments at 6; C-SPAN Comments at 4-5; Viacom Comments at 13-14, Attachment 1, at 37-38 (Bruce M. Owen & John M. Gale, Economists Inc., *Cable Networks: Bundling, Unbundling, and the Costs of Intervention* (July 15, 2004)).

[4] *See* Disney Comments at 18-20, Ex. 1, at 11.

Other examples of program services that have transitioned from a la carte to the benefit of consumers include New England Sports Network[5] and The Golf Channel.[6]

Programmers also provide economic projections to support the conclusion that a la carte or themed tiers would increase subscription fees and raise consumers' prices. For example, Discovery Communications presents data supporting its claim that:

> Discovery would have to receive from affiliates $3.18 per month per household for the Discovery Channel in order to attain existing revenue levels. This is more than 12 times today's rate, as the current per-subscriber wholesale price for the Discovery Channel is approximately $0.25 per month.[7]

Numerous programmers make similar projections.[8]

Virtually everyone in the multichannel video programming production and distribution industries agrees that consumers' prices would increase under mandatory a la carte -- including

---

[5] *See* NCTA Comments at 20 ("[W]hen New England Sports Network (NESN) was offered as a premium service, subscribers had to pay an extra $8 to $10 to receive it. When it became a basic tiered service in 2001, it add[ed] between $1 and $1.50 to the average cable customer's bill.").

[6] *See* Scripps Comments at 20 ("The Golf Channel also launched as an *á la carte* service in 1995. By 1996, it was teetering on the edge of bankruptcy because its subscription revenues at low take-rates could not cover its costs. The network then abandoned its *á la carte* model, transferred into expanded basic tiers, obtained wider distribution, and ultimately has become one of the most successful tiered programming services with about 60 million subscribers."); LAtv Comments at 7. These examples are consistent with Comcast's description in its initial comments of Home Team Sports ("HTS," now Comcast SportsNet). HTS was originally offered as an a la carte service in Baltimore County and had approximately 10,000 subscribers who paid $15.99 per month for the service. When it moved to an expanded basic tier, HTS could be seen by 170,000 subscribers who paid approximately $1.00 per month. *See* Comcast Comments at 27.

[7] Discovery Communications ("Discovery") Comments at 11 (citations omitted), Exhibit A ¶¶ 56-62 (Declaration of Robert D. Willig et al. Regarding A La Carte Pricing).

[8] Hallmark Channel ("Hallmark") Comments at 11 ("There can be no doubt that the price of the Hallmark Channel to viewers would increase by several orders of magnitude."); Court TV Comments at 29 ("Court TV estimates that in a pure a la carte environment it would have to charge customers at least $5.00 per month and maintain at least 85 percent of its current expanded basic carriage in order to remain profitable."); A&E Television Networks ("A&E") Comments at 29-30 ("If forced to transition to a la carte, [A&E Television Networks] estimates that it may have to charge as much as $2.00-$3.00 (U.S.) for each of its networks.").

cable operators;[9] DBS providers;[10] and programmers catering to a broad range of interests, including programming aimed at international and foreign-language audiences,[11] Latinos,[12] and women,[13] as well as family-friendly,[14] educational,[15] news,[16] and general entertainment programmers.[17]

Even state and local regulators concede that "[w]hat is not clear . . . is the impact that requiring a la carte pricing will have on subscriber rates," and that a la carte may actually increase consumer prices: "This is in part possible because the costs of certain new or niche programming may substantially increase as the costs of such programming are spread over fewer viewers."[18]

The record in this proceeding contains overwhelming evidence that consumers would pay more for programming under an a la carte or themed-tier scheme than they pay today under the

---

9 *See, e.g.*, Comcast Comments at 23-29; *Katz Analysis* ¶¶ 34-39; Time Warner Comments at 9-11; Charter Comments at 8-9, 10-11; Insight Comments at 3; NCTA Comments at 28-31; Advance/Newhouse Comments at 10-12.

10 *See, e.g.*, DIRECTV Comments at 2-4.

11 *See* Int'l Channel Networks ("Int'l Channel") Comments at 7 ("Because there is little or no opportunity for ICCP to reduce its programming costs (which already are very low), there is little doubt that it would have to increase substantially the subscriber fees for the International Channel to compensate for the loss in subscriber and advertising revenue that would result from a shift to a la carte carriage.").

12 *See* LAtv Comments at 2-3.

13 *See* Oxygen Comments at 7-8.

14 *See* GoodLife TV Network ("GoodLife TV") Comments at 4-5; Hallmark Comments at 10-11; Disney Comments at 12-18; Faith & Family Broadcasters Coalition ("Faith & Family") Comments at 6-8.

15 *See* Discovery Comments at 7-11.

16 *See* Bloomberg TV Comments at 7-11.

17 *See, e.g.*, Viacom Comments Attachment 1, at 44-45 & ¶ 6; Court TV Comments at 26; A&E Comments at 29-30; Fox Cable Comments at 14-18; Game Show Network ("GSN") Comments at 5-6.

18 National Association of Telecommunications Officers and Advisors ("NATOA") Comments at 5.

cable and DBS industries' tiering models. The Commission's report to Congress should fully reflect this fact.

B. A La Carte or Themed Tiers Would Reduce Program Diversity.

A tiny number of commenters argue that there is insufficient diversity in the video programming marketplace today and that a la carte or themed tiers would somehow cure this problem.[19] For example, Center for Creative Voices in Media ("CCVM") and Consumers Union and the Consumer Federation of America (collectively, "Consumers Union") argue that today's video marketplace lacks diversity because it is "controlled" by "media conglomerates." They believe that mandating a la carte will enhance diversity. As explained below, however, these assertions fly in the face of reason.

In its comments, Comcast demonstrated that a la carte or themed tier requirements would cause many niche program services to disappear and that many new services would never be launched.[20] The attached economic analysis prepared by Michael Katz ("*Katz Reply*") explains why "mandatory *a la carte* pricing would harm consumers . . . by reducing their choice of networks."[21] Specifically, "[t]he loss of low-cost mix-and-match viewing would be especially harmful to new and niche networks, thus reducing the number of such networks available to consumers."[22] Moreover, "[t]he ability of new networks to enter the market would be severely

---

19 *See* CCVM Comments at 5-9; Consumers Union Comments at 4-6; Black Education Network ("BEN") Comments at 2; Christian TV Network ("CTVN") Comments at 2-3; Urban Broadcasting Co. ("UBC") Comments at 2; *see also* Communications Workers of America ("CWA") Reply Comments at 5.

20 *See* Comcast Comments at 30.

21 Michael L. Katz, *Wrong Diagnoses, Wrong Cure: An Analysis of the Claims Made by Dr. Mark Cooper in "Time to Give Consumers Real Cable Choices"* ¶ 51 (Aug. 8, 2004) (attached as Attachment A) ("*Katz Reply*").

22 *Id.*

reduced" because of the "loss of consumers' ability to sample."[23] There is broad agreement on this conclusion among commenters, as well as among the independent economists empanelled by the Media Bureau for its July 29, 2004 symposium.[24]

For example, independent programmers pointed out that their niche and special interest services would be particularly hard hit by any type of a la carte or themed tier regulations. A joint filing by fifteen niche program services, including sports, religious, and entertainment programmers, explained that the key to survival -- namely, broad distribution -- would be compromised in an a la carte or themed tier regime.[25] Several other independent programmers predict a dim future if a la carte or themed tiers are mandated. For example:

- MBC Gospel Network, an African-American owned and operated program service, believes costs would be increased "so substantially that independent programmers, particularly those that appeal to minority audiences, would not survive."[26]

- Bloomberg TV asserts that many niche networks standing alone would "attract only a small number of viewers and would see their license fee and advertising revenues plummet to a point that cannot be overcome by raising their license fees. As a result, many of them would not survive."[27]

- Oxygen Media concludes that an a la carte mandate "would gravely threaten the survival of many networks, particularly recently-launched networks, and would

---

23 *Id.*

24 *See generally* FCC, *Symposium on "A La Carte" MVPD Pricing* (July 29, 2004) ("*A La Carte Symposium*") (Erik Brynjolfsson, Professor of Management, MIT Sloan School of Management; Gregory Crawford, Assistant Professor, Department of Economics, Eller College of Business and Public Administration, University of Arizona; David Waterman, Professor, Department of Telecommunications, Indiana University; Steven Wildman, Professor of Telecommunication Studies, Michigan State University), *at* http://www.fcc.gov/realaudio/mt072904.ram.

25 Altitude Sports & Entertainment et al. ("Joint Programmers") Comments at 29 (explaining that niche networks rarely succeed when delivered on an a la carte basis, whereas "a broad tier of diverse, niche networks *is* the business model that enables such networks to exist").

26 MBC Comments at 4.

27 Bloomberg TV Comments at 12-13.

assure that consumers are permanently deprived of seeing new networks created by independent entrepreneurs."[28]

- GoodLife TV affirms that, "While *a la carte* mandates would alter the business model upon which all cable program networks are based, independents like GoodLife would bear the brunt of the harm."[29]

- LAtv, a cable network providing entertainment and information to young, urban Latinos, says that "[t]he reduced revenue stream produced by a lack of subscribers would mean that many niche market television stations, such as LAtv, would no longer be able to survive financially in a competitive market."[30]

Even some of the largest programmers affirm that, although all services would be at risk when faced with unbundling mandates, niche services would face especially great risks.[31]

Of particular note is what advertisers say about the effects of a la carte or themed tiers on diversity and new networks, and how those effects will impact the advertising market. At the *A La Carte Symposium*, Jon Mandel, Co-CEO of MediaCom US and MediaCom Latino and Chief Global Buying Officer of MediaCom Worldwide, stated that "advertisers are worried about the unintended consequences of any FCC action on 'a la carte' cable which could further limit advertising avenues to reach our diverse population."[32] Mr. Mandel went on to explain that:

---

28 Oxygen Comments at 8; *see also A La Carte Symposium*, *supra* note 24 (statement of Oxygen Media Chairman and CEO Geraldine Laybourne) (explaining that new independent program services with original programming require investments of between "$350 million to $800 million," which "you can never justify . . . without carriage on a fully distributed programming tier"). Oxygen questions whether it could survive in an a la carte regime: "In order to compensate for . . . lost revenues and increased costs, Oxygen would have to increase its subscriber fees significantly and somehow reduce its costs to survive -- if survival were possible." Oxygen Comments at 7.

29 GoodLife TV Comments at 3.

30 LAtv Comments at 5.

31 Viacom Comments at 26 (explaining that BET's "existence clearly would be put in jeopardy" by an a la carte mandate); Fox Cable Comments at 8-9 (expressing doubts that it would have launched the National Geographic Channel in an a la carte world); NBC Universal Comments at 2 (stating that mandated a la carte is "far more likely to limit, rather than expand, the diversity of quality programming available to consumers").

32 Jon Mandel, MediaCom, *Cable . . . A La Carte or Basic: An Advertiser Perspective* 6 (July 29, 2004) (presented at *A La Carte Symposium*, *supra* note 24).

> The worst thing that happens to an advertiser is when the expected advertising is not delivered. That is why we expect a minimum level of committed subscribers before we can buy a new network. We know that the subscribers turn into viewers through trial. As marketers, advertisers know that there is no purchase without trial and there is no trial without availability/shelf space first and then consumer knowledge of availability. Thus, without the video supermarket that now exists, advertisers would not be able to support new networks.[33]

In short, it is clear that advertisers, which are the primary underwriters of programming (besides consumers themselves), believe that a la carte or themed tiers will have significant negative effects on the advertising market and ultimately decrease diversity.

There can be little doubt that, contrary to the views of CCVM and Consumers Union, a la carte and themed tier requirements would harm niche program services and have a grievous effect on diversity.[34]

C. Claims That the Current Marketplace Has Not Produced Program Diversity Are Misinformed.

In contrast to mandated a la carte, the current tiering model, as the Commission has found (and any viewer can see), has produced remarkable diversity in video programming. The Commission recently reported that, as of June 2003, there were 339 national cable program services and 84 regional program services.[35] The Commission noted that "the vast majority of Americans enjoy more choice, more programming and more services than any time in history."[36]

---

[33] *Id.* at 25.

[34] Significantly, although CCVM and Consumers Union generally assert that a la carte or themed tiers will promote diversity by increasing carriage opportunities for minority and independent programmers, they provide no explanation as to how or why this will occur or why almost every independent and niche programmer that argues that a la carte and themed tiers will harm diversity is wrong.

[35] *See In re Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 19 FCC Rcd. 1606 ¶¶ 17, 158, app. C table C-3 (2004) ("*Tenth Video Competition Report*").

[36] *Id.* ¶ 4.

Programmers point out that this “incredibly diverse array of programming” has been the result of tiering.[37]

Contrary to the assertions of CCVM and Consumers Union, much of this programming is created and produced by programmers that are not affiliated with cable operators. Although 53% of national program services were vertically integrated with cable operators in 1994, by June 2003 that number had decreased to 33%,[38] and now that Liberty Media has spun off its small cable holdings in Puerto Rico,[39] the percentage of programming networks vertically integrated with a cable operator is only about 26%.[40] Moreover, a more complete review of the programming marketplace would not look simply at who owns the program service, but would also take into consideration the fact that a significant portion of the programming distributed on

---

[37] Fox Cable Comments at 4; *see also* Cato Institute Comments at 2 (“[T]he modern MVPD industry largely owes its success to the practice of bundling . . . . MVPDs survived and thrived while consumers gained access to an ever-expanding array of video programming options.”); Bloomberg TV Comments at 6 (describing bundling as what has enabled BTV to “invest more of its budget in new and innovative services that respond to changing consumer preferences”).

[38] *See Tenth Video Competition Report* ¶ 17.

[39] Press Release, Liberty Media Corp., *Liberty Media Corporation Completes Spin Off of Liberty Media International, Inc.* (June 7, 2004), *available at* http://www.shareholder.com/libertymedia/ReleaseDetail.cfm?ReleaseID=136692.

[40] *See Tenth Video Competition Report* ¶ 143 n.587. Consumers Union takes this argument about “media conglomerates” to the level of absurdity. Unlike CCVM, Consumers Union identifies *six* dominant media companies. In addition to Viacom, GE/NBC, Disney, News Corp., and Time Warner, Consumers Union places “Liberty Media & Comcast” on the list. Consumers Union Comments at 5. Consumers Union’s effort to conflate these two independent companies into one for purposes of buttressing its weak argument is disingenuous. Today, Comcast owns a very small non-voting interest in Liberty Media that is not attributable under the Commission’s rules. *See In re Applications for Consent to the Transfer of Control of Licenses from Comcast Corporation and AT&T Corp., Transferors, to AT&T Comcast Corporation, Transferee,* Memorandum Opinion & Order, 17 FCC Rcd. 23246 ¶ 88 n.236 (2002). Comcast has no role in the management or operation of Liberty Media, does not have representation on Liberty Media’s Board of Directors, and has no overlapping officers or directors with Liberty Media. Moreover, Comcast and Liberty Media recently consummated a transaction under which Liberty Media exchanged a significant portion of Comcast’s non-voting shares in Liberty Media for, among other things, cash and other assets. Press Release, Liberty Media Corp., *Liberty Media and Comcast Complete Exchange of Liberty Shares for Programming Assets and Approximately $545 Million* (July 28, 2004), *available at* http://www.shareholder.com/libertymedia/ReleaseDetail.cfm?ReleaseID=140540. Consumers Union’s position is without merit.

services affiliated with cable operators is obtained from independent producers whose content is licensed and distributed via the service.[41]

CCVM and Consumers Union also claim that Comcast has diminished diversity by refusing to carry certain independent program services without first demanding and obtaining an equity stake in the services.[42] This claim is unsupported and unsupportable. First, Comcast has always complied and continues to comply with rules and statutes prohibiting any cable operator from engaging in this type of conduct.[43] Second, the vast majority of program services Comcast *does* carry are in no way affiliated with Comcast. In its Arlington, Virginia system, by way of example, Comcast delivers over 180 different *cable* program services, but it has an equity stake in only seven, or 3.9%, of those services.[44] Finally, Comcast's entire business relies on its ability to attract and keep subscribers to its service and, therefore, we have every incentive to carry, and do carry, a broad array of programming from a huge number of sources, whether independent or affiliated.

Although CCVM and Consumers Union purport to be concerned about the lack of minority programming, they disparage Comcast's decision to make a minority investment -- its first such investment following its acquisition of AT&T Broadband -- in TV One, a new, high-

---

[41] *See generally* Comcast Comments filed in Dkt. No. 98-82, at 18-20 (Jan. 4, 2002) (discussing the collapse of the programming distribution and packaging markets and the effects on independent producers' ability to gain carriage); Comcast Reply Comments filed in Dkt. No. 98-82, at 26-27 (Feb. 19, 2002) (same).

[42] CCVM Comments at 10; Consumers Union Comments at 5.

[43] *See* 47 U.S.C. § 536(a)(1); 47 C.F.R. § 76.1301(a). The Commission's rules set out the procedures for filing complaints if any party believes a cable operator or other MVPD has violated the prohibition. *See id.* § 76.1302. No party has filed any such complaint against Comcast. Consumers Union and CCVM offer only hearsay, and no facts, to support their allegation.

[44] To put this in perspective, the Commission's channel occupancy rules allowed cable operators to carry cable-affiliated programming on up to 40% of the first 75 channels carried on their network. 47 C.F.R. § 76.504. The U.S. Court of Appeals for the D.C. Circuit invalidated those rules on First Amendment grounds. *See Time Warner Entm't Co. v. FCC*, 240 F.3d 1126, 1139 (D.C. Cir. 2001).

quality program service aimed at the African-American audience,[45] perhaps the most underserved audience in America. In fact, Comcast carries many minority, ethnic, and foreign language program services in which it has no ownership interest, including CelticVision, CineLatino, CNN en Español, Discovery en Español, Fox Sports en Español, TVE Internacional, Utilísima, hTV Música, MTV Español, Si TV, TV Colombia, Latín TV, TV Chile, Grandes Documentales, Canal 24 Horas, CNC Colombia, Col TV, iSopresa, Multimedios TV, and Latinamerica TV.

Of course, Comcast does look for opportunities to invest in and create new program services.[46] We think that is good for consumers and for our business. TV One is an example of this strategy. Comcast met with a number of potential partners to explore the creation of a new program service aimed at the underserved African-American audience. Comcast was looking for a partner that offered the best combination of experience in minority programming, financial backing, marketing strength, and creative talent. Ultimately, Comcast chose to work with Radio One, the largest owner of radio stations targeting the African-American community, because it had these attributes and envisioned a service with the type of quality general entertainment and lifestyle programming that we believed our customers would want.

TV One was created by a partnership that included Radio One, financial investors, and Comcast. Each party brought unique assets and strengths to the partnership. In addition to a cash investment, Radio One contributed substantial management skills, extensive contacts in the

---

[45] The largest investor in TV One is Radio One, which also has management and operational control of TV One.

[46] Determining whether to invest in and create a new program service is a complex matter that involves a variety of factors. For example, in assessing a proposed service, Comcast considers whether the service would target a "unique/untapped" program category, appeal to advertisers, be affordable to produce, and have recognizable brands. Comcast Corp., *2004 Media Day Presentation* 25, 27 (June 30, 2004) (Presentation of Amy Banse, Executive Vice President, Programming Investments Division).

African-American community, and the ability to cross-promote TV One on its 69 radio stations. The financial partners brought investment capital. Comcast brought the ability to deliver and promote the service to consumers, providing a base of carriage as well as a substantial cash investment. Without the combination of these assets, TV One could not have been created.[47] Comcast is proud of its involvement in TV One and its role in bringing this diverse, high-quality program service to the marketplace.

II. CONSUMERS HAVE TECHNOLOGICAL OPTIONS THAT ARE FAR SUPERIOR TO A LA CARTE FOR BLOCKING PROGRAMMING THEY MAY FIND OBJECTIONABLE.

The Parents Television Council ("PTC") argues that mandatory a la carte and themed tier requirements are necessary because the current system "forces" parents who object to indecent programming to pay for such programming as part of an expanded basic tier.[48] While Comcast fully understands and appreciates parents' legitimate desire to control what programming their children watch and do not watch, we believe the most effective way to accomplish this is by parental control technology, not by mandatory a la carte and themed tier requirements with all of their attendant harms.

A. Cable's Parental Control Technologies Are the Best Means To Control Unwanted Programming.

Comcast and other cable companies have long provided tools to permit parents to control what channels are received and displayed in the home. And since early 2004, we have significantly increased our efforts to ensure that parents are aware of the tools we offer and how

---

[47] *See* TV One Supplemental Comments Declaration of Larry D. Gerbrandt at 4 ¶ 8 (noting that it can require $85-$150 million for an independent programmer to launch a new network and that a "new network typically does not launch until it can gain commitments from cable and satellite operators to launch in at least 10 million homes within the first two years").

[48] Parent's Television Council ("PTC") Comments at 3, 4; *see also* CWA Reply Comments at 7.

to use them. On March 2, 2004, Comcast sent a letter to the FCC Chairman and Commissioners outlining various measures that Comcast would take to educate customers about choice and control.[49]

The first of these measures involves the offering of traps, a form of signal filter that allows one or more channels delivered in analog to be completely blocked from reception inside the home.[50] Under the law, Comcast is allowed to charge its customers for installation of traps,[51] but as part of its commitment to help parents control their family's programming choices, Comcast provides these traps for free. To make sure that consumers are aware of this offer, Comcast has been publicizing the availability of traps on its website, through its program guide, in its customer welcome kits, on monthly billing statements, and through other customer communications. By way of example, if an analog cable customer does not want his or her children to watch *Real World*, a trap can be installed to block MTV.

Far more powerful and flexible tools are available to customers who choose to purchase digital cable service**.** Comcast's Parental Control feature on digital cable boxes -- accessed by remote control through the menu of the electronic program guide -- allows parents to block what their children can watch based on various criteria: by channel, program title, TV or MPAA rating, or time of day.[52] In addition, parents can hide titles of certain shows or create a list of

---

[49] *See generally* Letter from Stephen B. Burke, President, Comcast Cable Communications, Inc., to Chairman Michael Powell, FCC (Apr. 20, 2004) (on file with the author). Stephen Burke is now Chief Operating Officer of Comcast Corporation.

[50] Although, as Comcast pointed out in its initial comments, traps would not be useful as a means of delivering video programming on an a la carte or themed tier basis, *see* Comcast Comments at 37-38 & n.103, traps can be useful for blocking a small number of channels that a particular customer may find objectionable.

[51] *See* 47 U.S.C. § 544(d)(1).

[52] Set-top box manufacturers provide different ways to block programming. For instance, in various markets Comcast uses set-top boxes from Scientific Atlanta and Motorola, but both types of boxes provide consumers multiple blocking options.

"favorite" channels so that their families can surf only those channels. Thus, parents can effectively create a "family tier" by using the Favorites feature to select the channels they want their families to watch and by using parental controls to block the channels and programs they do not want their families to watch.[53]

Digital cable provides parents with a simple, yet powerful tool for controlling their family's television viewing. Digital cable is widely available to consumers. Comcast offers digital cable to 97% of its customers, and over 37% of them subscribe to the service. Digital cable is far less expensive than a la carte, which, as Comcast and others have demonstrated, would *significantly* increase consumers' cable bills.[54]

Because we have listened to our customers and heard their concerns, and because we agree that they should have an effective means to control the programming that is viewed in their homes, we have expanded our commitment to make parental controls more available and more user-friendly. We have added parental control icons to our video-on-demand menu to direct parents to this service, just as we had already done on our digital cable on-screen menu. In addition, since May of this year, we have been consistently running Public Service Announcements ("PSAs") highlighting the power of parental controls.[55] Comcast has also refined its website information on parental controls. We added a permanent "Parental Controls"

---

53 This approach is far more workable than a government requirement that cable operators create a family tier. As Comcast demonstrated in its initial comments, it would be difficult for a cable operator to create a family tier given the varied circumstances and interests of consumers. For example, how would a cable operator create a "family tier" that would appeal to families with both pre-schoolers and teenagers? How would a cable operator ensure that such a tier included programming responsive to the diverse ethnicity of the families it serves? *See* Comcast Comments at v, 16.

54 Comcast Comments at 23-29.

55 Comcast aired more than 64,000 PSAs across 24 leading cable networks and across more than 38 markets (which equates to over 360 advertising zones) from May 31, 2004 through June 27, 2004. These PSAs continue to run.

link to the "Find it Fast" section of our Comcast.com consumer website to enable consumers to obtain, in two mouse clicks, the specific parental control options for their cable system and equipment. The improved Parental Controls page has been viewed more than 10,000 times since its inception in April. We made sure that our customers know about our Parental Controls link by including a brief, clear, and prominent statement in our May and June customer bills, and we will voluntarily include these statements in our bills at least once a year.

In addition, we set up a dedicated "800" number so that our customers can easily reach service representatives who are prepared to answer their questions, walk them through the process of activating parental controls, and direct them to additional resources that will enable them to control their television viewing. In June alone, our service representatives answered over 7,500 calls to the Parental Controls Information Line.

Furthermore, starting in June of this year, Comcast made it a condition of any new carriage agreement with any cable program service that the service provide ratings for all of its programming. Also in June, Comcast began requiring any cable program service over which it exercises management control to either confirm that it currently provides television ratings information for its programming or start providing ratings information.

The parental control options described in this section are available today, without need for any changes in laws or rules. Most importantly, these options are available without new burdensome regulations, and without the harmful consequences that a la carte and themed tier requirements would bring to the many niche program services, including high-quality, family-friendly services that consumers enjoy today.

B. Customers Purchasing a Tier Do Not "Subsidize" Programming That They Do Not Watch.

PTC also argues that consumers "subsidize" programming they do not watch when they purchase a tier, and thereby support program services they may find objectionable.[56] But, as shown in the *Katz Reply,* "neither economic logic nor market facts" support the view that tiers force consumers to pay for programming they do not want.[57] Suppose, for example, that a consumer subscribes to a tier that contains a service he or she finds objectionable. It might appear that the consumer is being forced to purchase something he or she does not want in order to get the services he or she does want. However, once one takes into account that a la carte regulations would actually *increase* the price of programming, one sees the "fallacy of the argument that the consumer is being forced to pay more to get the programming he or she wants because other, unwanted programming is included in the tier."[58]

Analogies in the sale of other products support this view. For example, a cable customer is no more subsidizing a particular program service by subscribing to a tier in which that service is included than a purchaser of a newspaper is subsidizing a particular columnist with whom he or she disagrees. Nobody would think it reasonable for the newspaper purchaser to demand that the newspaper remove the objectionable columnist from the copy of the paper delivered to that purchaser and to reduce the price of the newspaper to exclude a pro rata share of the columnist's salary or fee. Similarly, a consumer who opts for the buffet at a restaurant may welcome having the choice of strawberry, apple, or rhubarb pie, but have a strong aversion to beets. It would be unreasonable for the consumer to insist that the restaurant remove the beets from the buffet

---

[56] PTC Comments at 1.

[57] *Katz Reply* ¶ 8; *see id.* ¶¶ 9-22.

[58] *Id.* ¶ 14; *see Katz Analysis* ¶¶ 20-21.

because he or she does not want to pay for them. The more appropriate response would be for the consumer to simply select the foods he or she does want and to pass on the beets. In fact, that is the point of the buffet -- the consumer is *not* paying for the beets, but for the opportunity to choose among the variety of options available in the buffet. Likewise, the point of the newspaper is that the reader pays for a variety of articles and columns so that he or she can choose to read those that interest him or her.

It is the same with cable program tiers. Cable customers pay for the variety of the tier, but this does not mean that they are "supporting" or "subsidizing" every service in the tier. And, as shown by Comcast and others, a requirement that a cable operator remove particular services from the tier certainly would not lower the price of the tier.[59]

In short, PTC's concern about consumers "subsidizing" programming they find objectionable is unwarranted. In fact, PTC's support for mandatory a la carte is at odds with its interest in promoting good quality and diverse family programming. As confirmed by the 2004 Beta Research Brand Identity Study, there is more family-oriented fare on cable television than anywhere else.[60] Providers of family programming have stated consistently that mandatory a la carte and themed tiers would *prevent* them from providing the depth and breadth of family programs they are able to provide under the current cable business model. For example, Judith McHale, President of Discovery Communications, told the Senate Commerce Committee that

---

[59] *See supra* Section I.A.

[60] Some 86% of survey respondents called Disney Channel family-oriented, followed by Cartoon Network (79%), Animal Planet (78%), Nickelodeon (75%), and Discovery Channel (72%). TV Land (72%), The History Channel (66%), ABC Family (65%), TLC (63%), HGTV (62%), Food Network (61%), and AMC (55%) also received that designation from a majority of cable subscribers. Each of these cable networks also topped broadcasters -- ABC (47%), NBC (45%) and CBS and Fox (42% apiece) -- in that regard. In gathering its survey results, Syosset, N.Y.-based Beta conducted telephone interviews in January with a random national sample of 600 cable subscribers. The study measured 41 networks with over 55 million subscribers, as well as the four major broadcast networks. *See* Mike Reynolds, *Cable's Friendly to Families, Beta Finds*, Multichannel News, Apr. 19, 2004, at 20, *available at* http://www.multichannel.com/article/CA411081?display=Top+Stories.

"Discovery's award-winning networks will not exist in an a la carte environment and consumers will have lost the channels they regard as the pre-eminent source of high quality, family-friendly programming."[61] A government policy that would have this effect makes absolutely no sense, particularly since parents *already* have the means to control the video programming that comes into their homes.

III. MANDATORY A LA CARTE AND THEMED TIERS INEVITABLY WOULD CREATE A MASSIVE NEW REGULATORY STRUCTURE.

The comments filed by a la carte proponents demonstrate convincingly that any a la carte or themed tier requirement the Commission adopts would inevitably bring with it a whole host of complicated and unnecessary new regulations. For example, Consumers Union suggests that regulations would be needed to: (1) define a la carte and themed tiers and set out the carriage obligations for cable and DBS operators; (2) define the circumstances under which a local broadcaster "serves community needs" and therefore qualifies for carriage on basic; (3) create a new public interest test that a national broadcast network would have to meet to qualify for carriage on basic; (4) require "adequate funding" for public, educational, and governmental access channels and define what is meant by that phrase; (5) define "independent program service" and a "public interest channel" and what it means that those services would be "promoted alongside" services owned by "major media corporations"; (6) define "diverse content providers" and what it means that these providers would be given "an easier path to

---

[61] Letter from Judith McHale, President and Chief Operating Officer, Discovery Communications, Inc., to Members of the Senate Committee on Commerce, Science, and Transportation (Mar. 8, 2004). Many other commenters have similarly warned that mandatory a la carte would dramatically reduce the variety and quality of programming available to consumers. *See supra* notes 24-29 and accompanying text; Comcast Comments at 30-33 (highlighting programmers' warnings about the dire effects of a la carte).

getting their programming out to the public"; and (7) define a new set of rate regulations that will ensure that set-top boxes are "made affordable to all consumers in an a la carte environment."[62]

NATOA states that, in order to require a la carte, the Commission's existing rules would need to be modified since they "forbid cable operators from offering [basic tier] channels a la carte."[63] NATOA also suggests that a la carte would require the Commission to adopt rules to: (1) ensure that carriage contracts between cable operators and programmers are open for inspection;[64] (2) require cable operators to carry on the basic tier all services for which they do not pay a license fee; (3) ensure that prices in rural and urban markets do not "vary significantly"; (4) adopt additional rate regulations for set-top boxes; and (5) allow local authorities to regulate the prices of the cable program service tier.[65]

Other commenters raise additional concerns about regulatory complications with a la carte. For example, some parties point out that a la carte has major implications for the retransmission consent rules, whether they argue for or against changes in those rules.[66]

---

62 Consumers Union Comments at 2, 9; *see* CWA Reply Comments at 8.

63 NATOA Comments at 4.

64 NATOA's proposal to require programmers and cable operators to allow public inspection of their privately negotiated carriage agreements is unworkable, unnecessary, and contrary to the Commission's rules. Carriage negotiations and agreements between cable operators and programmers involve a large number of variables and are highly sensitive. Cable operators and programmers have the right, as do entities throughout American business, to protect the confidentiality of their business negotiations. The Commission's rules expressly recognize that "[p]rogramming contracts between programmers and multichannel video programming distributors" are deemed "confidential." 47 C.F.R. § 0.457(d)(1) & (d)(1)(iv).

65 NATOA Comments at 8, 11-13, 15; *see also* CWA Reply Comments at 6-7.

66 *See* Paxson Comments at 2 ("Must carry and retransmission consent have nothing to do with cable operators' ability to offer their programming on an *a la carte* basis."); Fox Comments at 21 (supporting no change in the retransmission consent process because it "is fundamentally irrelevant to the issue of a la carte"); ACA Comments at 17-18 (attributing program packaging inflexibility in part to retransmission consent processes); EchoStar Comments at 4-7 (claiming that tying involved in the retransmission consent process frustrates the ability of MVPDs to offer programming a la carte). Other commenters believe that the Commission should examine retransmission consent in lieu of a la carte. *See, e.g.,* Discovery Comments at 21-22; BTV Comments at 14.

Professional and Collegiate Sports assert that a la carte would impact compulsory license and royalty rates, and would require the Commission to adopt regulations to define "sports tier," including the treatment of general entertainment program services that carry some sports programming.[67]

In addition, as Disney points out, if a la carte or themed tiers did not reduce consumer prices -- and Comcast and a host of others have shown that they would not -- there is a danger that old-style rate regulation will follow.[68] According to press reports, at a recent Senate Commerce Committee hearing on a la carte, Chairman McCain acknowledged this possibility.[69]

As Comcast demonstrates in its comments, the government's recent attempts to regulate program pricing and packaging created lasting harm to programmers, cable operators, and consumers alike.[70] In response to the 1992 Cable Act, the Commission adopted implementing regulations, adopted new regulations to overcome the unintended consequences of the first regulations, and, within four years, in response to Congressional direction, eliminated the regulations in their entirety. The Commission issued over 20 separate rate orders and hundreds of regulations, fact sheets, notices of inquiry, and notices of proposed rulemaking, comprising thousands of pages in the Federal Register. And the results of these efforts were: severe

---

[67] *See* Professional and Collegiate Sports Comments at 12-13.

[68] *See* Disney Comments at 27 (because a la carte will not reduce consumer prices, the "result would be inevitable pressure on the government to intervene even further in the form of attempted price controls"); *see also* Cato Institute Comments at 9 (fearing that if a la carte does not lower consumer bills, "some sort of price control scheme" will be suggested); NCTA Comments at 2 (stating that any required a la carte "portends new rounds of rate regulation, if 'voluntary' tiering and a la carte pricing doesn't deliver exactly the results its proponents seek").

[69] Ted Hearn, *Bodenheimer: A La Carte a Consumer Disaster*, Multichannel News, Mar. 25, 2004, *available at* http://www.multichannel.com/article/CA406048?display=Search+Results&text=bodenheimer ("After the hearing, McCain acknowledged that a la carte prices would need to be monitored, and perhaps even regulated, to ensure that consumers didn't opt for the tier by default because a la carte channels were priced at unreasonably high levels.").

[70] *See* Comcast Comments at 11-15.

cutbacks in programming and infrastructure investment; reduced program diversity; a nearly decade-long delay in the digital transition; and no improvement in consumer welfare.[71] The government should not adopt a la carte or themed-tier requirements that would force it to go down this road again.

IV. OTHER ISSUES

In this section, Comcast responds to several specific arguments raised by commenters:[72]

- Consumers Union's claim that the video distribution marketplace is not competitive is refuted by the facts, including the Commission's previous findings, and the record in the instant proceeding.[73]

- The consumer surveys relied on by Consumers Union are seriously flawed and their results cannot be taken as a meaningful indication of significant consumer demand for a la carte or themed tiers, particularly when their true consequences are understood.[74]

- The interdiction technology proposed by Blonder Tongue Laboratories is not suitable for delivery of video programming on an a la carte or themed tier basis.[75]

- NATOA's assertion -- that a brief effort by cable operators to use a la carte during a period of rate regulation over a decade ago is evidence that a la carte is a workable business model today -- is plainly wrong.[76]

---

[71] *See id*.

[72] We note that the early-filed reply comment of the Communications Workers of America ("CWA"), while purporting to present facts in support of a la carte, is in fact a thinly veiled attack on Comcast. While CWA's representations are largely irrelevant to this proceeding, we note for the record that Comcast is proud of its tradition as a good place of employment (as reflected in our selection as "Best Place to Work" in Massachusetts by the Boston Business Journal in May 2004). We invest in people with the belief that our company can only be as strong as our workforce. We believe employees should have the freedom to choose whether or not they work in a union environment and, indeed, Comcast is party to existing agreements with both the IBEW and CWA in various locations. Comcast continues to bargain in good faith with those unions at those locations and respects the right of its other employees to decide whether to have a union represent them through the process established by the National Labor Relations Board.

[73] *See* Consumers Union Comments at 1 ("Competition is virtually non-existent."); *see also* CWA Reply Comments at 6.

[74] *See* Consumers Union Comments at 9.

[75] *See generally* Blonder Tongue Laboratories Comments.

A. Consumers Union's Claim That the Video Distribution Marketplace Is Not Competitive Is Refuted by the Facts, Including the Commission's Previous Findings, and the Record in the Instant Proceeding.

Consumers Union repeats its thoroughly discredited argument that competition to cable is "virtually non-existent."[77] The Commission, the U.S. Government Accountability Office ("GAO"), and others have correctly concluded otherwise. In its most recent *Video Competition Report*, the Commission noted that today "most consumers have the additional choice of at least two national DBS providers."[78] As GAO, the investigative arm of Congress, has concluded, DIRECTV and EchoStar are "available nationwide," giving consumers the benefit of "a second and third formidable competitor in every market."[79] The Commission has also pointed out that the decline in DBS equipment prices, the provision of more advanced video and non-video services, and the offering of local broadcast signals has caused "DBS subscribership [to grow] rapidly."[80] Since its introduction, in fact, "the DBS growth rate has exceeded the growth rate of cable by double digits in every year except in the past year, when DBS growth exceeded cable growth by 9.16 percentage points."[81] And DIRECTV and EchoStar, "each among the five

---

76 *See* NATOA Comments at 3-4.

77 Consumers Union Comments at 1; *see* CWA Reply Comments at 6.

78 *Tenth Video Competition Report* ¶ 5.

79 U.S. Gen. Accounting Office*: Telecommunications: Wire-Based Competition Benefited Consumers in Selected Markets* 26 (Feb. 2004) (emphasis added). GAO recently changed its name to the Government Accountability Office, but the cited report was issued prior to the name change.

80 *Tenth Video Competition Report* ¶ 5.

81 *Id*. ¶ 8.

largest providers of multichannel video programming service,"[82] have "attracted former cable subscribers as well as consumers not previously subscribing to an MVPD."[83]

In addition to DBS, the Commission listed numerous competitive "distribution technologies operating in the market for the delivery of video programming," including broadband service providers, wireless cable systems, private cable operators, broadcast television, LECs, Internet providers, home video sales and rentals, and electric and gas utilities.[84]

For Consumers Union to continue to put forward the widely rejected notion that cable has no competition is evidence of willful blindness.[85] Even *Consumer Reports* magazine has confirmed that subscribers are getting more channels, cable has expanded channel selection and introduced HDTV, VOD, and high-speed Internet access, and that cable has improved its ranking in the magazine's consumer surveys.[86] In comparing cable and satellite options, *Consumer Reports* has advised consumers that: "Your biggest decision is whether to go with cable or satellite, but the choices don't stop there. You may have other options, including high-definition (HD) programming, video-on-demand (VOD), interactive TV, and digital recording."[87] Consumers Union's magazine has long been known for its objectivity and accuracy. Consumers Union's lobbyists should read the magazine's reporting more carefully.

---

82 *Id*. ¶ 16.

83 *Id*. ¶ 8.

84 *Id*. ¶ 16.

85 *See* CATO Institute Comments at 4 (pointing out that "vigorous facilities-based competition" is growing in the MVPD industry and "as this competitive drama unfolds, an a la carte mandate might skew marketplace outcomes in highly unnatural ways or unfairly tip the competitive balance"); *see also* Disney Comments at 4-6 (describing several MVPD market participants, including cable, DBS, broadcasters, and overbuilders).

86 *See Cable & Satellite: Which is Better?*, Consumer Reports, Mar. 2004, at 31.

87 *Cable or Satellite?*, Consumer Reports, Mar. 2003, at 12.

B. The Consumer Surveys Relied On by Consumers Union Are Seriously Flawed and Their Results Cannot Be Taken as a Meaningful Indication of Significant Consumer Demand for A La Carte or Themed Tiers, Particularly when Their True Consequences Are Understood.

Consumers Union relies on consumer surveys conducted in 2004 to assert that consumers "would prefer the option to pick only those cable channels they want to watch."[88] However, these surveys are so fundamentally flawed that their results are meaningless. Consumers Union mentions survey data on consumer preferences, but the questions posed in the survey are not reflective of the prices consumers would pay under a la carte. For example, of course, many consumers who pay $40 per month for 40 channels would rather be able to pick and choose among channels if each were offered for $1 per month, but that is not a realistic scenario. A more realistic survey should have asked whether consumers would rather get 40 channels for $40 per month or pay $5, $10, or even $15 per channel under a la carte.

As described above, the latter question reflects the view of virtually every programmer submitting comments in this proceeding that a la carte and themed tiers would dramatically increase the price of programming for consumers. Consumers Union's suggestion that a consumer who pays $40 for a 40 channel tier would pay $1 per channel in an a la carte world is misleading. Consumers Union's claims, as well as the surveys on which they rely, provide no insight.[89]

---

[88] Consumers Union Comments at 10.

[89] *See generally A La Carte Symposium*, *supra* note 24.

C. The Interdiction Technology Proposed by Blonder Tongue Laboratories Is Not Suitable for Delivering Video Programming on an A La Carte or Themed Tier Basis.

Blonder Tongue Laboratories manufactures "TV Channel Blocker," an analog blocking interdiction technology, which it asserts would allow cable operators to provide a la carte and themed tier services in analog cable systems.[90] This type of interdiction technology has been around for many years in a variety of forms from various manufacturers. It is not suitable for delivering video programming on an a la carte or themed tier basis.

The TV Channel Blocker, like other interdiction technologies, requires that a device be placed on the cable plant outside a customer's home. The cable signal must be sent over the cable system in an unscrambled form and, when it reaches the TV Channel Blocker, a particular program service can be blocked so that it does not enter the customer's home. This is an entirely uneconomic approach for delivering video programming. These types of interdiction devices are expensive,[91] require cable operators to send a cable technician to every home for installation, can create a theft of service risk, and may not have the capacity to handle the dozens of analog channels delivered by cable systems today. The limitations associated with analog interdiction technology are well documented.[92]

---

90 *See generally* Blonder Tongue Laboratories Comments at 1-2.

91 Since interdiction is a signal denial technique, interdiction systems require that hardware be placed at the home of every customer of a cable system that chooses programming a la carte. This is the primary reason why cable operators historically have not viewed interdiction as cost effective.

92 *See* James Careless, *A Dirty Little Secret*, CED Magazine (Aug. 2001) (highlighting a number of concerns with analog interdiction technologies, including manpower-related installation costs, equipment costs, and signal theft, as well as diverting industry resources away from the conversion to digital); Caroline March-Long, *Trying To Lock the Door on Piracy*, CED Magazine (Aug. 2001) (quoting a senior cable industry engineer as saying with respect to analog interdiction: "There are a limited number of things one can do in the analog world that don't end up messing up the picture or costing too much."); *see also In re Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992: Buy-Through Prohibition*, 8 FCC Rcd. 2274 ¶ 9 (1993) (noting that analog trapping technologies are "highly labor- and cost-intensive").

The TV Channel Blocker is designed for -- and for the reasons described above is of limited to use in -- an analog environment. The cable industry is involved in a massive effort, funded by tens of billions of dollars of its own risk capital, to complete a transition to a digital environment, a goal that is strongly supported by Congress and the Commission. It would make no sense for the government to force the industry to divert these resources to invest in and deploy (and require consumers to pay for) an analog-based technology in order to implement a la carte or themed tiers, especially since Comcast and others have repeatedly shown that a la carte or themed tiers would mean increased prices and less programming for consumers.

Finally, as Comcast and others have pointed out, technical infeasibility is only one of a host of reasons why mandatory a la carte and themed tier requirements would be bad for consumers, programmers, and cable operators.[93]

D. NATOA's Assertion That a Brief Effort by Cable Operators To Use A La Carte During a Period of Rate Regulation over a Decade Ago Is Evidence That A La Carte Is a Workable Business Model Today Is Plainly Wrong.

In its comments, NATOA cites the Commission's *Comcast City of Tallahassee* decision, which it asserts shows that the cable industry used a form of "a la carte/tier" to "evade" the Commission's rate regulation rules in the mid-1990s.[94] NATOA says that this decision proves that a la carte is a workable model for cable operators to provide programming to consumers. For several reasons, NATOA is wrong.

First, NATOA misreads *Comcast City of Tallahassee*. That case involved Comcast's decision to move one channel from its 13-channel Limited Service tier and three channels from

---

93 *See supra* Sections I.A.-B.; *see also* Comcast Comments at 37-39; Charter Comments at 10-12; NCTA Comments at 6-8.

94 NATOA Comments at 3-4 (citing *In re Comcast Cablevision City of Tallahassee, FL, Letter of Inquiry*, Memorandum Opinion and Order, 9 FCC Rcd. 7773 (1994) ("*Comcast City of Tallahassee*")).

its Satellite Service tier to create a new four-channel package. Customers could purchase the entire four-channel package or they could purchase any of the four services individually. The Cable Services Bureau held that its rate rules had created "confusion as to whether collective offerings of a la carte channels constituted an evasion of regulation" and that Comcast's restructuring "did not constitute a clear evasion of our rate rules."[95] As a result, the Bureau did not require Comcast to pay refunds or retier the four-channel package.[96] The full Commission upheld the Bureau's decision.[97]

Second, Comcast only offered four services a la carte and very few of our customers opted to purchase any of the four services individually.[98] As a result, Comcast did not have to deal with the scale of technical and operational problems that would arise if it were required to offer numerous channels a la carte and if a significant number of its customers were actually to choose to purchase programming in that manner. Moreover, Comcast did face technical and operational hurdles for those few customers who did choose a la carte in Tallahassee. For example, every a la carte customer required a set-top box, which meant that Comcast had to send a technician to his or her home. Likewise, every time a customer wished to change service, Comcast had to dispatch a technician back to the house.[99] For these and other reasons, Comcast

---

95 *Comcast City of Tallahassee* ¶¶ 21, 23.

96 *See id*. ¶ 23.

97 *In re Comcast Cablevision City of Tallahassee, FL, Letter of Inquiry Application for Review,* Memorandum Opinion and Order, 11 FCC Rcd. 1246 (1995).

98 *See Comcast City of Tallahassee* ¶ 13.

99 Comcast ultimately waived the set-top box and service change fees, but the costs to Comcast were real and waiver of the fees would not be an option if a significant number of customers opted for a la carte.

has not used this approach in any significant way in the ten years since *Comcast City of Tallahassee*, nor have any of the many other competitors in this marketplace.

Third, as Comcast demonstrated in its comments, a la carte *would* create significant operational costs for cable operators that ultimately would be borne by consumers.[100] For example, it would require Comcast to redesign and re-implement its order taking, billing, and customer care operations; deploy millions of expensive new digital set-top boxes; upgrade its headend equipment to handle the vastly increased number of transactions that would occur in an a la carte world; and increase its marketing budget to promote each individual program service rather than promoting the entire tier. In fact, the effort required to convert to a la carte would be so massive that it would effectively consume the attention of our cable systems' management, technical, and customer service personnel, thereby delaying rollout of advanced services that consumers really want, including home networking, VoIP, high-speed Internet, HDTV, video-on-demand, and digital video recorders.

Many other commenters agree. For example, Insight Communications explains why mandatory a la carte or themed tier requirements would be "unfeasible from a technical standpoint"[101] and would cause severe operational problems for cable operators.[102] Charter Communications points out that "customer interactions would become much more cumbersome under an a la carte regime," and that customers would be frustrated by the "length and

---

[100] *See* Comcast Comments at 33-41.

[101] Insight Comments at 4-18 (describing the technical problems associated with any of the potential options for delivering a la carte or themed tiers, including the use of traps, hybrid set-top boxes, conversion to an all-digital platform, and simulcasting).

[102] *See id*. 18-22 (explaining that a la carte or themed tiers would make it impossible to market program services effectively, cause great disruption in customer service operations, and produce virtually incomprehensible customer bills).

complexity of the a la carte subscription process" and the "accompanied . . . serious billing difficulties."[103] NCTA describes the operational costs of a la carte or themed tiers and how those costs would result in higher cable prices for consumers.[104] There is nothing in the record that refutes these points.

V. THE COMMISSION'S REPORT SHOULD FULLY REFLECT THE FACT THAT THE ECONOMIC AND POLICY RECORD IN THIS PROCEEDING IS OVERWHELMINGLY IN OPPOSITION TO MANDATORY A LA CARTE OR THEMED TIERS.

Often when the Commission initiates a proceeding seeking public comment on an issue, commenters provide a varying degree of opinion, some in support of a particular outcome, some opposed. This is not such a proceeding. Here, the overwhelming number of commenters -- particularly those who have taken the time to substantiate and support their arguments with economic analysis and real-world experience -- strongly oppose mandatory a la carte or themed tiers. Of course, the Commission will look to the merits of the arguments, and Comcast believes the record makes clear that an a la carte or themed tier requirement would harm programmers, cable operators, and consumers alike.

The record also shows that the opposition to mandatory a la carte and themed tier requirements was deafening and the support for such requirements was barely a whisper. The breadth and diversity of parties in opposition was extraordinary. It included programmers, civil rights groups, free-market groups, religious organizations, women's groups, state and local elected officials, cable operators, DBS providers, sports interests, motion picture studios, and

---

[103] Charter Comments at 12-13.

[104] *See* NCTA Comments at 27-28 ("billing costs would . . . go up because of the complexity of a la carte options"; the increased volume of calls necessitated by a la carte "would, on average, add to operators' costs by more than $2 per subscriber per month").

more. The Commission's report to Congress should reflect the depth and intensity of this opposition.

VI. CONCLUSION

The overwhelming majority of commenters responded to the Commission's questions about a la carte or themed tiers with a common answer: Mandatory a la carte or themed tiers would *increase consumer prices* and *decrease program diversity*. From every perspective -- that of cable operators; large, small, minority, and niche programmers; DBS operators; civil rights groups; religious groups; think-tanks; sports rights owners; state and local elected officials; and others -- comes the warning that mandatory a la carte and themed tiers will harm consumers, programmers, and distributors.

In addition, in these Reply Comments, Comcast demonstrates that technological solutions are far superior to mandatory a la carte or themed tiers for consumers who want to avoid programming they may find objectionable. In particular digital cable, which is available today to 97% of Comcast's customers, provides a powerful yet economical way for parents to create a "family tier" or to block programs in a number of ways, such as by channel, rating, time, or program title. And it does so without the harmful consequences of a la carte or themed tiers to the many niche program services, including high-quality, family-friendly services that consumers enjoy today.

Comcast also shows that customers who prefer only certain services included in a tier do *not* "subsidize" programming they do not watch (no more so than purchasers of a newspaper "subsidize" columnists they do not read); rather, each consumer pays for the option of viewing a wide variety of programming including the programs they want to watch, which would be significantly more expensive if offered on an a la carte basis.

In light of the evidence in the record, Comcast strongly believes that the primary message in the Commission's report to Congress should be: **The video distribution market is competitive; consumers have many options for obtaining video programming; competition and choice are expanding, not contracting; and there is no conceivable basis for the government to mandate a la carte or any other package or price regulations on cable operators, DBS operators, or any other video market participants.**

Respectfully submitted,

/s/ Michael H. Hammer

Michael H. Hammer
Ryan G. Wallach
Stephanie L. Podey
WILLKIE FARR & GALLAGHER LLP
1875 K Street, N.W.
Washington, D.C. 20006-1238
Attorneys for Comcast

Joseph W. Waz, Jr.
COMCAST CORPORATION
1500 Market Street
Philadelphia, PA 19102

James R. Coltharp
COMCAST CORPORATION
2001 Pennsylvania Avenue, N.W.
Suite 500
Washington, D.C. 20006

Thomas R. Nathan
COMCAST CABLE COMMUNICATIONS, INC.
1500 Market Street
Philadelphia, PA 19102

August 13, 2004

WRONG DIAGNOSIS, WRONG CURE:
An Analysis of the Claims Made by Dr. Mark Cooper in "Time to Give Consumers Real Cable Choices"

Michael L. Katz*

8 August 2004

* This report was commissioned by Comcast Corporation. The views expressed are those of the author and do not necessarily reflect the views of Comcast Corporation.

CONTENTS

EXECUTIVE SUMMARY

In a recent paper, Dr. Mark Cooper attacks the cable television industry's practice of offering consumers various bundles of networks through tiered pricing, and he calls for public policies that would force cable system operators to offer programming on a network-by-network, or *a la carte,* basis. In the present paper, I analyze Dr. Cooper's central claims. The analysis shows that Dr. Cooper's claims are based on fundamentally flawed and incomplete arguments that lack sound factual or logical foundations.

In particular, Dr. Cooper makes a number of mistakes:

- *He erroneously argues that tiers force people to pay for programming they don't want.*
- *He fails to take industry cost conditions into account in his analysis of a la carte pricing.*
- *He is fundamentally confused about the economics of mixed bundling.*
- *He falsely implies that a la carte pricing is a cure for market power.*
- *He fails to take into account the fact that cable networks are themselves bundles of programs.*
- *His claims about cable operators' ownership of cable programming are incomplete and misleading.*
- *He incorrectly diagnoses a carriage problem and, in any event, mandatory a la carte pricing would not be a cure.*
- *His projections of the effects of mandatory a la carte pricing on network variety are exactly backwards.*
- *He fails to address the practical problems of unbundling regulations.*
- *He correctly diagnoses must-carry regulations as a problem for consumers but identifies the wrong cure.*

Contrary to Dr. Cooper's unsound claims, mandatory unbundling would very likely harm consumers, competition, and economic efficiency.

I. INTRODUCTION

1. In a recent paper, Dr. Mark Cooper attacks the cable television industry's practice of offering consumers various bundles of networks through tiered pricing.[1] He asserts that his "analysis demonstrates that the cable industry practice of forced bundling is anti-consumer and anticompetitive."[2] Central to his "analysis" is the claim that "[f]orcing consumers to buy large bundles of channels, most of which they do not watch, in order to gain access to the small number that they do wish to view results in a higher total bill."[3] He concludes that "[a] simple requirement that cable operators offer consumer[s] an *a la carte* choice of channels, in addition to any bundles they offer, would be a dramatic improvement."[4] In short, Dr. Cooper is calling for a requirement that cable system operators engage in what the academic literature calls *mixed bundling*. Under mixed bundling, the same channels would be offered both on an *a la carte* basis and as part of a tier.[5]

2. Unfortunately, Dr. Cooper has unbundled his conclusions from sound policy analysis. Moreover, he frequently substitutes rhetoric for a careful look at market facts and for the

---

1 Dr. Mark Cooper, "Time to Give Consumers Real Cable Choices: After Two Decades of Anti-Consumer Bundling and Anticompetitive Gate Keeping," (hereafter, *Cooper on Bundling*) Consumer Federation of America and Consumers Union, July 2004. This paper was attached to Consumers Union and Consumer Federation of America Comments filed before the Federal Communications Commission *In re Comment Requested on A La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems*, Public Notice, MB Dkt. No. 04-207 (July 15, 2004) (hereafter, *A La Carte Proceeding*).

2 *Cooper on Bundling* at 1.

3 *Ibid.*

4 *Ibid.* at 3.

5 It is critical for mixed bundling that the *same* channels be available both ways. Hence, a cable system is not engaged in mixed bundling when it offers HBO on an *a la carte* basis at the same time that it offers tiers that do not include HBO.

rigorous application of fundamental economic logic. At one point, Dr. Cooper is appropriately cautious about his conclusions. Referring to himself in the plural, he states that

> We use conditional words – would, could – to describe these possible effects because the results will emerge from the interaction of three forces, cable operator interests, programmer interests and, to a much greater extent than ever, consumer preferences.

But Dr. Cooper fails to examine seriously the interaction of these three forces. Consequently, his central conclusions about both the existence of problems and potential solutions to these alleged problems are misleading. In the present paper, I explain many, but not all, of the errors contained in Dr. Cooper's report.[6]

3. The principal claim made in favor of mandatory *a la carte* pricing is that consumers would pay less for cable television programming because they would pay only for those networks they affirmatively choose to pay for, rather than being "forced" to pay for access to programming networks they do not wish to view. Although intuitively appealing, this claim is false. The source of the error is the failure to take into account several critical features of the cable television industry (specifically, the nature of programming and distribution costs and the fact that even a single network is a bundle of programs) and the failure to analyze the economic

---

[6] I do not exhaustively cover the incorrect claims made by Dr. Cooper both because of the lack of time to address all of them and because many are irrelevant to the issues at hand. Moreover, some of the errors are repetition or elaboration of errors committed in his earlier paper, Mark Cooper, "Cable Mergers, Monopoly Power and Price Increases," Consumer Federation of America, January 2003, and were addressed in my earlier paper, Michael L. Katz, "An Economic Analysis of the Claims Made by Dr. Mark Cooper in 'Cable Mergers, Monopoly Power and Price Increases,'" 28 July 2003 (hereafter, *Katz Analysis of Cooper*).

incentives and needs of programmers, advertisers, and cable system operators to cover their costs while taking consumer preferences into account.[7]

4. A proper economic analysis indicates that mandatory unbundling policies would very likely harm consumers and reduce economic efficiency by:

- inefficiently reducing the benefits derived from existing programming;
- raising the retail price of existing cable programming; and
- reducing the range and quality of programming available.[8]

Under mandatory unbundling, consumers would view a narrower range of lower quality programming and would pay more for that programming on a per-channel basis. Indeed, consumers could quite possibly end up paying higher total bills despite the reduced quality and variety of programming viewed.

II. THE CURRENT SITUATION

5. Cable television system operators are far from being alone in offering products to consumers in bundles. The practice of offering multiple products together in a single bundle is widespread: automobiles, newspapers, pairs of shoes, long-term apartment leases, and buy-one-get-one-free offers are all examples of bundles. Moreover, bundling is often associated with discounts, as with buffet dinners and baseball season tickets. Further, suppliers often use

---

7 As the term is used here, economic efficiency is measured by the extent to which the consumption benefits enjoyed by consumers exceed the costs of providing the good or service to them. Suppose, for example, that it costs $5 million to create a new video game and $2 per disc to manufacture game CDs and distribute them to consumers. Once the content creation costs have been sunk, it is efficient to distribute a disc to any consumer who values listening to the disc by more than $2: doing so maximizes the surplus of benefits over costs. For example, if a consumer derives $30 of enjoyment from playing the game, then distributing a disc to that consumer will increase net benefits by $28 = $30 – $2.

8 For a presentation of the analysis leading to these conclusions, see, for example, Michael L. Katz, "Slicing and Dicing: A Realistic Examination of Regulating Cable Programming Tier Structures," 15 July 2004, (hereafter, *Katz on Unbundling*).

bundles to compete.[9] For example, when they entered as multi-channel video distributors ("MVPDs"), both DIRECTV and EchoStar relied on large bundles of programming to compete with incumbent cable system operators. At the time they launched their services, neither direct broadcast satellite ("DBS") operator had significant market power. In a competitive setting, suppliers have to seek the least-cost way of getting benefits to consumers in order to be successful. The behavior of DIRECTV and EchoStar thus suggests that the use of tiers by MVPDs is not motivated by the exercise of market power but is, instead, an effective and low-cost way to deliver the benefits of multi-channel video programming to consumers.

6. Today, most cable system operators, DBS operators, and Broadband Service Providers, such as Knology and RCN, offer many different tiers of service, as well as programming available on a per-channel or per-view basis. For instance, most cable systems today offer two to three analog tiers, including a *basic tier* (which includes broadcast channels; public, educational, and governmental channels; and leased access channels) and an *expanded basic tier* (which typically includes 20 to 40 popular cable television networks such as CNN and The Discovery Channel). In addition, a typical system offers one to four digital tiers, and sometimes several more. In many instances, foreign-language tiers are available. Consumers have the freedom to choose among these tiers without restriction other than the government-mandated requirement that they purchase the basic tier. The net result is that most consumers have a wide variety of options and multiple providers from which to choose.

7. There are three critical features of the cable industry that distinguish it from the industries to which standard analyses of bundling apply:

---

9 For a more detailed analysis of several examples, see David Evans and Michael Salinger (2004) "Why Do Firms Bundle and Tie? Evidence from Competitive Markets and Implications for Tying Law," *Yale Journal of Regulation,* in press.

- *The costs of creating programming are independent of the number of viewers.* It costs the same amount to create a cable television program whether that program is watched by a thousand viewers or a million. Society incurs no additional programming costs when a cable television subscriber views a particular cable network.
- *Distribution costs are lower for tiers than for a la carte offerings.* Tiers give rise to cost savings because they allow the use of less expensive subscriber premises equipment (*e.g.*, set-top boxes) and reduce cable system operators' customer care costs, such as processing bills and orders, and handling customer questions.
- *Cable television networks are themselves bundles.* A given cable television network is a bundle of different programs. The programs of a single network may fall into a variety of categories, including news, sports, and family-friendly. Moreover, an individual viewer typically values these different programs by widely varying amounts.

Each of these three factors drives the conclusion that mandatory unbundling would harm consumers and efficiency in the MVPD market.

III. DR. COOPER ERRONEOUSLY ARGUES THAT TIERS FORCE PEOPLE TO PAY FOR PROGRAMMING THEY DON'T WANT

8. Like other proponents of mandatory unbundling, Dr. Cooper claims that tiers force consumers to pay for programming they do not want. For example, he asserts that

> Clearly, households are being forced by [sic] pay for many channels that they do not want. … Forcing consumers to buy large bundles of channels, most of which they do not watch, in order to gain access to the small number that they wish to view results in a higher total bill.[10]

But, in truth, neither economic logic nor market facts support this assertion.

9. There are two sources of error that render Dr. Cooper's analysis of no value. First, he completely neglects important and fundamental characteristics of multi-channel video distribution. In doing so, he misapplies the economics of standard goods to an information good. Second, he makes the mistake of believing that to ask what would happen if a single consumer were allowed to make *a la carte* purchases is an appropriate means of predicting the effects of an

---

10 *Cooper on Bundling* at 1.

industry-wide public policy. In doing so, he ignores changes in prices and programming offerings that would harm consumers and economic efficiency.

10. In the remainder of this section, I consider each of these errors in turn.

A. Dr. Cooper Fails To Account for the Costs of Creating and Distributing Programming

11. A fundamental problem with Dr. Cooper's argument is that it confuses the economics of standard commodities, such as shirts or cans of tuna fish, with the economics of information goods, such as cable television programming.[11] When a good consists primarily of information, such as software, a movie, or a cable television program, there often are huge costs associated with creating the first copy of the product, but very little cost to create additional copies or allow additional users. For example, the cost of developing a new word processing system would be millions of dollars, but once the system is developed, copies could be distributed over the

---

[11] In an earlier paper commissioned by Comcast (*Katz Analysis of Cooper*), I used a simple analogy to show that one has to look at price per unit to assess consumer welfare effects. Dr. Cooper takes this analogy and misapplies it. Dr. Cooper writes,

> Comcast's approach provides a useful starting point. It likens cable bundling to a greengrocer who sells tomatoes for $2 per pound, but who might also sell five pounds for $7.50. The tomatoes are cheaper on a per unit basis in the bundle (a volume discount) although the total bill is greater. [*Cooper on Bundling* at 39.]

So far, he is correct. However, he goes on to write that:

> The fundamental problem is that greengrocers invariably give the consumer a wide range of choices. … Cable operators do not give consumers that much choice.
>
> In fact, cable operators give consumers almost no choice. If I really need two pounds of tomatoes for my spaghetti sauce, I have to take all five pounds and most of the other fruits and vegetables, even though the rest are of little value to me. My next door neighbor, who really needs two pounds of apples for her pie, is forced to buy five pounds of apples and the tomatoes and all the other fruits and vegetables, too. We both end up paying a higher price and, given the nature of the commodity, we cannot recapture the surplus through trade. [*Cooper on Bundling* at 39 and 40. Internal footnote omitted.]

Internet at a cost of pennies each. It is widely recognized among economists that bundling can be an efficient way to distribute information goods.[12]

12. The argument that people are forced to pay for something they do not want implicitly assumes that including more channels in a tier raises the cost to society of providing that service. But, for the reasons discussed above, this implicit assumption is false: the additional cost of providing an existing cable subscriber access to additional networks in a tier is negative because of the costs that would have to be incurred to exclude the customer from receiving selected networks. Unbundling would not lower the social costs of creating programming, but it would raise the costs of distributing programming. Hence, unbundling would raise total costs. Ultimately, these higher costs would adversely affect consumer welfare. For example, mandatory unbundling policies could force people to lease set-top boxes for which they have little use. And—unlike programming—real resources are consumed and wasted each time a consumer has to get a set-top box.

B. Dr. Cooper Fails To Account for the Price Changes that Would Be Triggered by Mandatory *A La Carte* Pricing

13. To see the second fundamental flaw in Dr. Cooper's argument, suppose a consumer subscribes to a tier containing a network that the consumer does not value watching. It might appear that the consumer is being forced to purchase something he or she doesn't want—the unwatched network—in order to get to get the services he or she does want—the other channels. However, removing that network from the tier could be expected to reduce other consumers' willingness to pay for the tier and thus reduce the extent to which those consumers contribute to

---

12 See, for example, Yannis Bakos and Eirk Brynjolfsson (1999) "Bundling Information Goods: Pricing, Profits, and Efficiency," *Management Science* **45:** 1613-30; Hanming Fang and Peter Norman (2003) "An Efficiency Rationale for Bundling Public Goods," Cowles Foundation Discussion Paper No. 1441, Yale University; and Evans and Salinger (2004), supra note 9.

covering the costs of the first consumer's preferred programming. Hence, dropping the network from the tier might well lead to the first consumer's paying more for the programming he or she does watch. Suppose, for example, that cable programmers and cable system operators need to recover an average of $40 per subscriber to cover the costs of providing cable services to consumers. Now compare two situations. In the first, every consumer purchases a tier of 40 channels for $40. In the second, each consumer purchases only his or her ten favorite networks. To cover the industry's costs, cable operators still have to collect an average of $40 per subscriber, which could be done by charging $4 per channel. One could try to assert that consumers are better off in the second situation because they pay only for the channels that they want, but, in fact, the first situation is clearly superior from the consumer perspective because a household pays the same amount for cable service ($40), but has a much wider range of options.

14. Once one takes the nature of programming and distribution costs into account and recognizes the need for programmer and system operators to adjust their prices following the introduction of mandatory *a la carte* pricing, one sees the fallacy of the argument that the consumer is being forced to pay more to get the programming he or she wants because other, unwanted programming is included in the tier.

15. Far from protecting consumers from paying for networks they don't value, mandatory *a la carte* pricing would very likely will lead to higher prices for a number of reasons. In short, these reasons are:

- *Programming costs would be amortized over fewer subscribers per network.* Even if total viewing were to remain unchanged, *a la carte* pricing would lead to each network's having fewer subscribers. Unbundling would thus raise the subscription fees needed to cover the fixed costs of creating programming because these costs would have to be amortized over a smaller number of subscribers per network.
- *Mandatory unbundling would raise the total costs of creating and distributing cable programming.* The costs of distributing cable television programming would rise

because of increased equipment and customer care costs. Further, mandatory unbundling would not give rise to any savings in the costs of producing programming. Hence, total costs would rise. Ultimately, these higher costs would be reflected in retail prices.

- *Mandatory unbundling would reduce overall cable viewership, which ultimately would raise the prices to consumers.* Restrictions on tiers would reduce overall cable television viewing and would thus reduce opportunities for operators and programmers to generate advertising revenues. The diminished advertising revenues would create incentives for cable networks and systems to charge higher prices. Moreover, programming costs would be amortized over less total viewing.[13]

C. Simple Numerical Examples Illustrate the Illogic of the Argument Made by Dr. Cooper and Other Proponents of Mandatory Unbundling

16. A series of simple numerical examples further illustrate the flaws in Dr. Cooper's analysis. Indeed, the very existence of these examples—in which consumers pay as much or more under *a la carte* pricing as under tiering—demonstrates that the purported logic of the claim that bundling forces consumers to pay more cannot possibly be correct.

17. In these examples, there are only two cable channels, but the insight generalizes to more realistic numbers. The first example also assumes that an integrated monopolist produces both cable television networks and distributes them on a single cable television system. In reality, virtually all cable systems face competition, and most cable networks are owned by companies that are not cable system operators.[14] The assumptions of monopoly and vertical integration are made here for simplicity and do not alter the central implications of the example. Consideration of an integrated monopoly facilitates tracking the full cost consequences of unbundling. As discussed below, the analysis can be extended to more realistic—and correspondingly complex—situations. The examples are also structured so that any given consumer values only one of the two networks. Again, this is done for simplicity. In addition, this is exactly the type

---

13 For additional discussion of these effects, see *Katz on Unbundling,* Section V.B.

14 For a discussion of ownership patterns, see Section VII below.

of situation in which Dr. Cooper should assert that *a la carte* pricing would benefit consumers because they allegedly "would not have to pay for networks they don't watch."

18. In the first example, consumer demand for the two networks has the following structure. There are 200 consumers total. Half of these consumers are willing to pay $10 per month to view network *X*, but $0 to view network *Y*. Each of the other 100 consumers is willing to pay $0 per month to view network *X*, but $10 to view network *Y*. On the cost side of the market, each programming network costs a fixed amount, *F*, per year to create. Cable system construction costs are assumed to be sunk. When the two networks are offered only as a single tier, there is an ongoing per-subscriber distribution cost of *c*, which is assumed to be sufficiently less than $10 per month that the cable system operator can cover its costs. This figure includes the costs of maintaining a billing account, as well as the costs of any necessary equipment in the customer's home, such as a set-top box.

19. Each consumer is willing to pay at most $10 per month for a tier that contains two networks. Thus, under bundling, the cable operator would maximize its profits by setting the tier price at $10 per month and all consumers would obtain the rights to view both networks. Under *a la carte* pricing, the cable operator would maximize its profits by setting a price at $10 per month per network. In other words, consumers would pay just as much to purchase a single channel under *a la carte* pricing as they would pay to receive *both* channels on a tier.

20. In fact, consumers might well be worse off than this simple example suggests. Under more realistic conditions—in which *a la carte* pricing triggers additional distribution costs (*e.g.*, the need for addressable set-top boxes)—consumers would pay *more* to purchase a single channel under *a la carte* pricing than they would pay to receive *both* channels on a tier! This

fact is formally demonstrated in the Appendix.[15] Intuitively, the reason is that mandatory *a la carte* pricing would force consumers to pay for set-top boxes, sophisticated billing systems, and more costly ordering systems that many would not value. The effects of mandatory unbundling are worse still once one recognizes that, in fact, people typically value access to multiple networks so that *a la carte* pricing inefficiently limits mix-and-match viewing benefits.[16]

21. Although the example above assumes that the creation and distribution of multi-channel video programming is monopolized by an integrated supplier, that industry structure is not essential to the finding that mandatory *a la carte* pricing harms consumers and leads to their paying more to receive less. The Appendix analyzes an example showing that one can obtain the same result in an industry in which program creators and distributors are independent firms and both program creation and distribution are subject to competition. It is shown that, at best, a consumer pays more to get the same programming under *a la carte* pricing as under tiering. At worst, the consumer pays more to get less programming under *a la carte* pricing. Either way, mandatory unbundling harms consumers. The reason is clear. By ignoring fixed costs of programming, *a la carte* proponents act as if consumers are going to get something for nothing. But the programming costs do not go away simply because fewer viewers have the right to watch each network. Someone has to pay these costs.

22. One can quibble about the specifics of the hypothetical examples presented here, but the fundamental point remains: the argument made by unbundling proponents is not logically sound. If it were, these examples would not exist.

---

15 The demonstration in the Appendix also shows that Dr. Cooper's belief that proofs of the harmfulness of mandatory unbundling rely on special properties of linear demand curves is incorrect. (*Cooper on Bundling* at 39.)

16 For a discussion of mix-and-match viewing benefits, see Section VI below.

IV. DR. COOPER IS FUNDAMENTALLY CONFUSED ABOUT THE ECONOMICS OF MIXED BUNDLING

23. Dr. Cooper writes:

> Thus, we recommend what is known in the literature as mixed bundling – the offer to select either channel packages and or [sic] channels on a stand-alone basis. Pure bundling, the situation in which programs are offered only in packages, and pure component selling, the situation in which packages are outlawed, have consistently been found to be inferior in the economics literature.[17]

Similarly, Dr. Cooper asserts that, by introducing consumer choices, mixed bundling "would diminish the ability of cable operators to extract surplus."[18] These are extraordinary statements—indicative of a profound misunderstanding of the literature and the underlying economic logic—because the sense in which mixed bundling has consistently been found to be superior to other forms of pricing is in terms of generating seller profits![19] Mixed bundling would provide cable operators with the *greatest* ability to extract surplus. The logic underlying this conclusion is clear: under mixed bundling the seller has the greatest pricing flexibility and can thus do the most to generate profits. Put another way, anything that the seller could do under pure component pricing or pure bundling, it could also do under a particular set of mixed-bundling prices. Therefore, absent transaction costs, a monopoly seller *never* could be worse off under mixed bundling than under other pricing regimes. Dr. Cooper appears to have completely misunderstood both the academic economics literature and the fundamental logic underlying the issue.

---

17 *Cooper on Bundling* at 6.

18 *Ibid.*

19 See, for example, R. Preston McAfee, John McMillan, and Michael D. Whinston (1989) "Multiproduct Monopoly, Commodity Bundling, and Correlation of Values," *Quarterly Journal of Economics* **104**: 371-84.

24. Dr. Cooper also asserts that "The policy question before the [Federal Communications] Commission is why has the cable industry resisted mixed bundling so fiercely?"[20] He is correct that this is an important question. But he provides the wrong answer. According to Dr. Cooper, "the answer is that the current rate structure reflects the exercise of substantial market power by cable operators who engage in bundling to extract consumer surplus, control the flow of content and increase their profit."[21] But as just discussed, the economics literature unambiguously demonstrates that mixed bundling would give cable operators the greatest ability to extract consumer surplus and, in the absence of significant transactions costs, would raise operator profits.

25. So why don't cable system operators engage in mixed bundling? By far the most probable answer lies in the fact that the academic literature has shown that mixed bundling is more profitable than pure bundling *when transaction costs are low*. The fact that cable system operators do not pursue mixed bundling strategies suggests that the costs of offering cable networks on an unbundled basis are significant.[22] Stated in terms of policy implications, current practices indicate that mandatory unbundling would generate significant costs for service providers and their customers.

---

20 *Ibid.*

21 *Ibid.*

22 As summarized in *Katz on Unbundling*, Section III.B, unbundling would trigger significant additional equipment costs, additional marketing costs, and additional billing costs, among others.

V. DR. COOPER INCORRECTLY IMPLIES THAT *A LA CARTE* PRICING IS A CURE FOR MARKET POWER

26. Dr. Cooper asserts that cable operators are monopolists.[23] The U.S. Department of Justice and many others have concluded otherwise.[24] Each cable system operator in the United States faces competition, at a minimum, from two national direct broadcast satellite television providers.[25] However, suppose—purely for the sake of argument—that cable operators were local monopolists with substantial market power.[26] Even if this were true, mandatory *a la carte* pricing would not be a cure for the problems associated with the exercise of substantial market power.

27. First, the academic literature establishes that bundling often is efficient in comparison with selling unbundled components *even if (unlike here) the supplier is a monopolist and bundling gives rise to no transaction costs savings*. If *a la carte* pricing were mandated and no other price controls were put in place, then a cable operator would be free to charge whatever price for a network the operator chose, as long as that network was offered on a stand-alone basis. As shown by the work of Adams and Yellen, among others, banning bundling by a profit-maximizing monopolist could harm economic efficiency.[27] The academic literature thus

---

23 *Cooper on Bundling,* Section III.

24 See, for example, *U.S. et al. v. EchoStar Communications Corp., Hughes Electronics Corp., General Motors Corp., and DIRECTV Enterprises, Inc.,* Complaint, United States Court for the District of Columbia, filed October 31, 2002, which defines a multi-channel video programming distribution market, including cable and DBS operators.

25 There may be certain parts of Alaska and Hawaii in which DBS reception is poor, but almost no cable systems or households are affected.

26 Dr. Cooper's discussion of market power mischaracterizes both the economics literature and U.S. antitrust policy. For example, he asserts that "[m]arkets with the equivalent of fewer than 6 equal-sized competitors … are considered tight oligopolies" and that "collusion among them is relatively easy." (*Cooper on Bundling* at 9 [internal footnote omitted] and footnote 20.) As a general statement about antitrust economics, Dr. Cooper's assertion is false.

27 William J. Adams and Janet L. Yellen (1976) "Commodity Bundling and the Burden of Monopoly," *Quarterly Journal of Economics* **90**: 475-98.

provides a clear warning to those who claim that unbundling would lead to pricing that better promotes efficiency as measured by the extent to which consumption benefits exceed supply costs.

28. Second, Dr. Cooper advocates the use of mixed bundling. However, as noted above, the academic literature has unambiguously established that—in the absence of transactions costs—mixed bundling is the most profitable possible selling strategy! This hardly sounds like a recipe for reducing market power or its exercise.

VI. DR. COOPER FAILS TO TAKE INTO ACCOUNT THE FACT THAT CABLE NETWORKS ARE THEMSELVES BUNDLES OF PROGRAMS

29. Dr. Cooper asserts that mandatory *a la carte* pricing would give consumers a greater range of options. But he fails to conduct a complete analysis of consumer opportunities and choices. Under *a la carte* pricing, viewing options come at a price. This fact matters because cable networks are themselves bundles of programs. Dr. Cooper completely misses the fact that mandatory *a la carte* pricing would harm consumers by distorting their viewing of existing programming. Specifically, by inefficiently suppressing mix-and-match viewing and program sampling, mandatory *a la carte* pricing would reduce the benefits that consumers derive from available programming. Consider each effect in turn.

30. *A la carte pricing would discourage consumers from efficiently engaging in mix-and-match viewing.* A tier with a large number of networks allows a consumer efficiently to select certain programs shown on a given network even if he or she does not wish to view all of the programs on that network. This selective viewing can take place on a planned basis, such as when a viewer tunes in to Outdoor Life Network during the Tour de France. Or the viewing can be on the spur of the moment, such as when a viewer tunes in to CNN or Fox News during a fast-

breaking major news story. With *a la carte* pricing, a consumer faces incremental charges when he or she wishes to watch programming on an additional network, and thus that consumer will be discouraged from watching programming on a wide range of networks. In short, *a la carte* pricing does not allow viewers cheaply to mix-and-match programming from different networks.

31. *A la carte pricing would discourage consumers from efficiently sampling alternative cable networks.* Consumers often are unsure or even unaware of what programming is available. Even if a consumer has some information about a program, she may not know her full reaction to it until she actually sees it. When the consumer subscribes to a tier containing a large number of channels, she can readily sample programming on the included networks—there are no extra charges for watching programs on a wide range of networks on either a one-off or repeated basis. In contrast, under *a la carte* pricing, the consumer would have to subscribe to a network whenever she wanted to sample a program on that network. In addition to the out-of-pocket expenses, the consumer would have to incur the time and hassle of ordering the network. Therefore, unbundling would have an additional adverse effect: consumers would be denied a low-cost means of learning about programming that they have not yet seen. Consumers and economic efficiency would be harmed by the absence of a low-cost means of sampling because consumers would be unable to find and view the mix of available programming that best suited their tastes.

32. Because he does not conduct an appropriately complete analysis, Dr. Cooper misses these adverse effects of mandatory *a la carte* pricing.

VII. DR. COOPER'S CLAIMS ABOUT CABLE OPERATORS' OWNERSHIP OF CABLE PROGRAMMING ARE INCOMPLETE AND MISLEADING

33. Dr. Cooper claims that programming in which cable system operators have ownership interests have "guaranteed carriage"[28] and that "[b]ecause the current system is so discriminatory against independent programming, we believe that *a la carte* could expand the opportunity for independent programming."[29] Dr. Cooper also asserts that, because of their ownership interests in program creators, cable operators do not have incentives to restrain programming costs.[30]

34. There are several flaws in Dr. Cooper's analysis of cable system operators' carriage decision-making process and its effects on program diversity and prices. Specifically, he:

- misleadingly implies that most cable system operators own much of the programming they carry;
- misleadingly implies that this ownership creates incentives for inefficient favoritism;
- misleadingly claims that cable operators do not have incentives to restrain programming costs;
- incorrectly asserts that mandatory *a la carte* pricing would remedy the problem he alleges; and
- fails to account for the negative effects of mandatory *a la carte* pricing on program diversity.

The remainder of this section addresses the first three of these errors in turn. The final two are addressed in subsequent sections.

---

[28] "Moreover, each of the dominant programmers has guaranteed access to carriage on cable systems – either by ownership of the wires (cable operators)…" *Cooper on Bundling* at 35.

[29] *Ibid.* at 8 [text in original is in bold font].

[30] According to Dr. Cooper "GAO finds that cable operators are majority owners of one-fifth of the top 90 national networks" and "A one-fifth share of the most popular programs is a very substantial stake in the programming market and it blunts cable operators' incentive to resist price increases." (*Cooper on Bundling* at 27.)

A. Dr. Cooper's Claims about Cable System Operators' Ownership of Programming are Misleading

35. The fact is that most of the networks carried by cable systems are not owned by the systems carrying them. Most networks are not owned in whole or in part by any cable system operator.[31] Moreover, even when a cable system operator owns a national programming network, most of the viewers of that network typically are subscribers on cable systems or DBS systems that are not owned by the integrated provider. CNN, for example, is owned by the parent of Time Warner Cable Inc. The number of CNN subscribers on cable and DBS far exceeds the number of Time Warner Cable subscribers. Calculations based on Federal Communications Commission ("Commission") data show that over 82 percent of cable subscribers receiving CNN are on cable systems operated by companies that do *not* have an ownership interest in CNN.[32] CNN is also carried by EchoStar and DIRECTV, neither of which owns CNN. Even if Time Warner engaged in the sort of discrimination or guaranteed carriage that Dr. Cooper alleges, this could not explain CNN's success with other operators. This example is not an isolated one. Thus, it is difficult to see a basis for Dr. Cooper's claim that there is a widespread problem that arises because cable system operators guarantee carriage or otherwise discriminate in favor of programming networks that they own.

---

31 See Section VII.C below.

32 According to data reported by the Commission, in June 2003 CNN had 86.2 million subscribers (Table C-5), Time Warner had 11.6 percent of multi-channel video programming delivery service subscribers (Table B-3), there were 70.5 million cable subscribers (Table B-1), and 94.2 million household subscriptions to multi-channel video programming delivery services (Table B-1). (*In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 03-172, January 28, 2004, (hereafter *Tenth Competition Report*).)

A conservative estimate of the number of subscribers to CNN on cable systems not owned by Time Warner is found by assuming there were 10.9 million (= 11.6% × 94.2 million) CNN subscribers on Time Warner systems and 23.7 million (= 94.2 million – 70.5 million) on non-cable services. The resulting estimate is 51.6 million (86.2 million – 10.9 million – 23.7 million). Hence, a conservative estimate of the percentage of cable subscribers to CNN on cable systems not owned by Time Warner is 82.6 percent, which is equal to 51.6/(51.6+10.9).

B. Dr. Cooper's Claims about Cable System Operators' Incentives To Resist Programming Price Increases Are Incomplete and Misleading

36. Dr. Cooper misleadingly claims that cable operators do not have incentives to restrain programming costs. The fact is that the cable systems serving the vast majority of Americans own very little of the programming that they carry. Moreover, even for vertically integrated companies, increases in the costs of creating programming are not simply transfers. Further, if programming costs were simply transfers, then cost increases would have no impact on consumer welfare.

37. First, consider the facts on system operator ownership of the programming they carry. According to data reported by the Commission, the nation's largest cable company, Comcast, as well as three other major cable companies, Cablevision, Charter and Adelphia, had *no* ownership interests in *any* of the top 15 programming services measured by prime-time ratings.[33] For these companies, *none* of the price increases of the top 15 channels is an internal transfer. The data similarly show that another major cable operator, Cox, has ownership interests in a total of only two of these top channels (and those interests are minority interests). Indeed, only one of the top six cable system operators, AOL Time Warner, can even arguably be said to have significant ownership interests in top-15 programming services. And even AOL's interests extend to only three of the top 15 measured by prime time ratings. The data for the top 20 channels measured by subscribers tell a similar story: Charter and Adelphia have no ownership interest in any of the top 20 programming services, and Comcast and Cablevision each have minority interests in one channel, Cox has minority interests in two channels, and AOL Time Warner owns four

---

[33] *Tenth Competition Report*, Table C-7.

channels.[34] Thus, in the vast majority of instances, price increases by the top 20 programming services are paid for by cable system operators that have no ownership interests in those programming services. Moreover, in many cases, the ownership interests are significantly less than 100 percent, so any price increases would not be a wash.

38. Even in those cases where a cable system operator owns 100 percent of a programming service, Dr. Cooper's analysis of vertical integration is incomplete to the point of being unsound. In order to draw inferences about the effects of programming price increases on a firm that is vertically integrated into both creating programming and operating cable systems, one must understand why programming prices are rising. If programming prices are rising due to increases in the amounts paid by programmers to their suppliers (ultimately actors, producers, writers, athletes, and technicians), then even a fully vertically integrated company will experience real cost increases that are not "just transfers" within the company. Similarly, if a cable system operator is spending more on cable programming because it is offering more programming, additional resources will be expended producing the new programming, whether or not the cable system operator is vertically integrated. Dr. Cooper does not examine these issues, and thus his paper provides no basis for his claim.

39. Lastly, Dr. Cooper commits a fundamental economic error. If programming costs really were simply transfers, then increases would have no impact on consumer welfare. It is well established that a profit-maximizing seller that operates as a unitary decision maker bases its retail prices on the underlying costs of providing the service, not internal transfer prices. Thus, if

---

[34] *Tenth Competition Report*, Table C-6. Comcast now owns 57 percent of QVC, which is the thirteenth largest programming service measured by subscribers.

Dr. Cooper's claims about transfers were correct, then these transfers would be irrelevant to consumers.

C. Dr. Cooper's Analysis of Cable System Operators' Carriage Incentives Is Incomplete and Misleading

40. According to Dr. Cooper, the current industry structure leads to extensive discrimination and/or anticompetitive practices that limit opportunities for independent programming.[35] A central part of his argument appears to be the claim that cable system operators have incentives to engage in harmful discrimination against programming networks that the operators do not own. Economic logic, however, demonstrates that cable system operators have strong economic incentives to show the programming that their customers value highly relative to the costs of that programming. Dr. Cooper's claims to the contrary notwithstanding, empirical findings that he cites are consistent with this economic logic.

41. Cable system operators have economic incentives to carry a broad array of programming to attract subscribers. Roughly speaking, a cable system operator's profits are equal to revenues that the system collects from subscribers and advertisers minus programming and system costs. Higher revenues are better, all else equal. Programming that households find appealing attracts both additional subscribers and creates a more attractive services to sell to advertisers. Thus, cable system operators have economic incentives to offer programming that consumers find desirable. This is so whether the operators are monopolists or competitors.

42. The fact that cable system operators have incentives to carry programming that their customers value does not mean that programming costs are irrelevant. An economically rational system operator will take those costs—as well as consumer preferences—into account in making

---

35 *Cooper on Bundling,* Section IV.

carriage decisions. If there are two substitute networks that are equally valuable to consumers and one is available more cheaply to the cable system operator, then the operator has economic incentives to carry that network instead of the more expensive one. This, too, is true whether the operator is a monopolist or faces intense competition.

43. By carrying their own programming, cable operators may avoid a problem that is known in the economics literature as double marginalization.[36] Double marginalization refers to the following situation. Firm *A* sells an input to firm *B*, which then sells its output to consumers. Firm *A* marks the price of the input up over its costs. Firm *B* then treats that marked-up price as its cost and further marks up the price. Because there are two margins on top of the initial cost, there is said to be double marginalization. Double marginalization can distort market outcomes because the second firm treats the marked-up amount as its cost, even though the marginal cost to society is the unmarked-up cost.

44. Double marginalization arises when a programming network owner sets the price it charges to cable operators above its marginal costs and cable system operators then treat that network's price as a marginal cost of their own. Because programming is an information good, the marginal cost to the creator associated with another household's viewing that programming is near zero. However, many programming networks charge cable system operators positive per-subscriber fees. These fees represent a marginal cost to a cable operator when it attracts additional subscribers to that network. But, as just described, the true marginal cost to society is near zero. Thus, this pricing may lead to fewer subscribers than is efficient. The source of the problem is that most of the per-subscriber charge levied by the programmer is simply a monetary

[36] In addition to pricing benefits, integration may similarly lead to better coordination in the creation of programming that matches the desires of the system operator's subscribers.

transfer from the operator to the programmer. As such, it does not represent a cost to society overall—the programmer gains what the operator loses. But it is a very real cost from the operator's perspective.

45. A firm that is both a cable programming producer and a system operator may internalize these effects. That is, the firm's central management may direct the two divisions to work together and recognize that the marginal programming costs to the integrated company from attracting additional subscribers are near zero. An integrated company would thus tend to charge lower prices to consumers and attract more subscribers than otherwise.[37]

46. Dr. Cooper cites empirical findings that are consistent with this view. He quotes a study that found cable system operators favored programming in which they had ownership interests by "pricing them lower or marketing them more vigorously" than might otherwise be expected.[38] Similarly, Dr. Cooper states that the GAO found that "cable operators do not charge more for their own shows, but they are much more likely to air them."[39] These findings are consistent with the logic of internalization through integration.

47. Market facts also belie any claim that cable programming networks cannot survive without cable system ownership. According to the Commission, there were 339 satellite-delivered national programming networks, of which 229 (or approximately two thirds) were not vertically integrated with any cable system operator.[40] Even this number understates the extent

---

37 A similar effect can arise with respect to advertising revenues. The division of advertising revenues between a programmer and a system operator can distort the behavior of unintegrated firms.

38 *Cooper on Bundling* at 28 quoting David Waterman and Andrew A. Weiss (1997) *Vertical Integration in Cable Televisio*n. Washington, D.C.: AEI Press, at 7.

39 *Cooper on Bundling* at 27.

40 *Tenth Competition Report*, ¶141, Table 8. The data cited here do not appear to comport fully with those reported in Appendix C to the *Tenth Competition Report*. The reasons for the differences are unclear, but the differences are minimal.

to which programmers are independent of cable system operators. Liberty Media was counted in these Commission data as being vertically integrated even though Liberty Media had no cable systems in any of the fifty states. The Commission included Liberty Media's programming networks because Liberty Media was "a cable operator through its ownership of Cablevision of Puerto Rico" and thus met the statutory requirements for inclusion as a vertically integrated cable company.[41] Treating Liberty's networks as being independent of cable system operators, the number of non-integrated programmers rises to 256.[42]

VIII. EVEN IF DR. COOPER HAD CORRECTLY DIAGNOSED A CARRIAGE PROBLEM, MANDATORY *A LA CARTE* PRICING WOULD NOT BE A CURE

48. Dr. Cooper claims that *a la carte* pricing would unleash forces that would end what he sees as undue discrimination. In particular, he asserts that:

> Cable operators would come under pressure to remove their own shows from bundles, if the number of consumers who choose *a la carte* is significant, but the shows they choose are not owned by cable operators.
>
> The ability of large national programmers to force large packages of channels into the expanded basic bundle could be put under pressure, if consumers show an *a la carte* preference for a small subset of its channels.
>
> Programmers who achieve a significant *a la carte* following could gain considerable leverage with advertisers, since they are delivering a dedicated and perhaps distinctive audience.[43]

49. As just discussed, Dr. Cooper has misdiagnosed the situation. But even if Dr. Cooper were right about the existence and source of a problem, he has failed to prescribe a cure. Specifically, mandatory *a la carte* pricing would do nothing to change operator incentives. If

---

41 *Ibid*. footnote 587.

42 This calculation is based on the 27 services that are affiliated with Liberty and are not affiliated with another cable operator. (*Tenth Competition Report,* Table C-1.)

43 *Cooper on Bundling* at 8.

cable system operators behaved the way in which Dr. Cooper hypothesizes, why wouldn't they simply refuse to carry independent channels on either an *a la carte* or bundled basis?

50. Moreover, new and niche networks would have trouble ever achieving a significant following under mandatory *a la carte* pricing. This fact leads to perhaps the most serious problem with Dr. Cooper's claims about programming supply, to which we now turn.

IX. DR. COOPER'S PROJECTIONS OF EFFECTS OF MANDATORY *A LA CARTE* PRICING ON NETWORK VARIETY ARE EXACTLY BACKWARD

51. If Dr. Cooper's proposed remedy were merely irrelevant, one might not be concerned about his policy proposal. But for a number of reasons already discussed, mandatory *a la carte* pricing would be harmful to consumers and economic efficiency. Another way mandatory *a la carte* pricing would harm consumers would be by reducing their choice of networks. The specific mechanisms by which this harm would occur include:

- *The supply of niche networks that attract many of their current viewers on an occasional basis would be severely reduced.* The loss of low-cost mix-and-match viewing would be especially harmful to new and niche networks, thus reducing the number of such networks available to consumers.

- *The ability of new networks to enter the market would be severely reduced.* The loss of consumers' ability cheaply to sample would be particularly harmful to new networks.

- *Mandatory unbundling would reduce overall cable viewership and thus reduce the range and quality of programming available.* Moreover, the adverse effects would likely fall disproportionately on new and niche networks because their subscriber bases would fall relative to those of established, broad-based networks and advertisers tend to follow audiences.

Consequently, the long-run effect of restricting tiers is to restrict viewer choice.[44]

52. The networks themselves—particularly new and niche networks—recognize the harm they would suffer under mandatory *a la carte* pricing. Fifteen niche program services, including sports, religious, and entertainment programmers explained to the Commission in a joint filing that

> a broad tier of diverse, niche networks ***is*** the business model that enables such networks to exist. A niche audience network, such as **iLifetv,** or a niche program network such as **CGTV,** that would not exist today if distributed *a la carte,* can thrive if distributed as part of a broad tier.[45]

Scripps Networks, Inc. (the producer of lifestyle networks Do It Yourself Channel, Fine Living, Food Network, and Home & Garden Television) warned about the adverse effects of mandatory *a la carte* pricing on new programming and networks:

> Scripps Networks, like other networks, simply would not be able to continue to invest in new programming without the distribution certainty that the current market provides. In addition to investing in fewer new series programs or specials, the company might have to halt its consideration of developing a Hispanic network.[46]

Other programmers question their survival if *a la carte* pricing is mandated. For example, LAtv (a cable network catering its entertainment and information programming to young, urban Latinos) predicts that "[t]he reduced revenue stream produced by a lack of subscribers would mean that many niche market television stations, such as LAtv, would no longer be able to

---

[44] Further, by forcing a less attractive business model on programmers and cable system operators, mandatory unbundling would also reduce the quality of programming available to viewers.

[45] Altitude Sports & Entertainment, et al. Comments filed in the *A La Carte Proceeding*, MB Dkt. No. 04-207, at 29 (July 15, 2004) [emphasis in original]. Seven of these fifteen program services are affiliated with Comcast Corporation and eight are independent.

[46] Scripps Networks, Inc. Comments filed in the *A La Carte Proceeding*, MB Dkt. No. 04-207, at 22 (July 15, 2004).

survive financially in a competitive market."[47] MBC Gospel Network (an African-American owned and operated program service) believes costs would be increased "so substantially that independent programmers, particularly those that appeal to minority audiences, would not survive."[48] And GoodLife TV asserts that "[w]hile *a la carte* mandates would alter the business model upon which all cable program networks are based, independents like GoodLife would bear the brunt of the harm."[49]

X. DR. COOOPER FAILS TO ADDRESS THE PRACTICAL PROBLEMS OF UNBUNDLING REGULATIONS

53. Dr. Cooper calls for *a la carte* pricing in addition to tiers.[50] According to Dr. Cooper, "the regulatory intervention we propose is far from intrusive."[51] As discussed in my earlier report, it is impossible to see how this is so. *A la carte* pricing regulations would raise troubling questions about whether they would be workable and would end up leading to a very complex system of price regulation having adverse unintended consequences.

---

47 LAtv Holdings, LLC Comments filed in the *A La Carte Proceeding*, MB Dkt. No. 04-207, at 5 (July 15, 2004); *see also* Bloomberg Television Comments filed in the *A La Carte Proceeding*, MB Dkt. No. 04-207, at 12-13 (July 15, 2004) (asserting that many niche networks standing alone would "attract only a small number of viewers and would see their license fee and advertising revenues plummet to a point that cannot be overcome by raising their license fees. As a result, many of them would not survive." [internal footnotes omitted]).

See, also, Oxygen Media Corporation Comments filed in *A La Carte Proceeding*, MB Dkt. No. 04-207, at 8 (July 15, 2004) (concluding that an *a la carte* mandate "would gravely threaten the survival of many networks, particularly recently-launched networks, and would assure that consumers are permanently deprived of seeing new networks created by independent entrepreneurs"). Indeed, Oxygen questions whether it could survive in an *a la carte* regime: "In order to compensate for . . . lost revenues and increased costs, Oxygen would have to increase its subscriber fees significantly and somehow reduce its costs to survive -- if survival were possible." *Ibid.* at 7.

48 MBC Gospel Network LLC Comments filed in the *A La Carte Proceeding*, MB Dkt. No. 04-207, at 4 (July 15, 2004).

49 GoodLife TV Network Comments filed in the *A La Carte Proceeding*, MB Dkt. No. 04-207, at 3 (July 15, 2004).

50 "Rather than try to dictate bundles, or ban them, we propose to allow cable operators to offer bundles that they want, but also make the channels they choose to bundle available on an *a la carte* basis." (*Cooper on Bundling* at 6.)

51 *Ibid*.

54. Suppose that Dr. Cooper got his wish and cable operators were required to offer networks on an *a la carte* basis in addition to their current tiers. The question would almost certainly arise whether the *a la carte* prices were "too high" relative to the bundled prices. Industry critics such as Dr. Cooper would very likely assert that they were. Critics would very likely also assert that price regulation was needed to prevent cable system operators from offering such large discounts for purchasing multiple channels that single-channel purchases were not realistic alternatives. As experience has shown, however, any attempt to regulate price levels and structures is likely to be very complex and give rise to adverse unintended consequences.[52] The need to engage in such price regulation is yet another cost and drawback of mandatory unbundling.[53]

XI. DR. COOPER CORRECTLY DIAGNOSES MUST-CARRY REGULATIONS AS A PROBLEM FOR CONSUMERS BUT INCORRECTLY IDENTIFIES THE CURE

55. Dr. Cooper correctly identifies must-carry obligations as anti-consumer. As he observes, "[t]he decision of Congress to give broadcasters must-carry/retransmission rights has enabled broadcasters to gain a significant advantage for their programming, in terms of carriage."[54] To the extent that channel capacity is a scarce resource, mandatory carriage rights run the risk of distorting carriage decisions (*i.e.*, an operator may be forced to carry certain broadcast channels instead of cable networks that would better serve consumer interests but for which there is insufficient system capacity).

---

[52] As I have noted elsewhere, "rate regulation is very difficult in an industry such as cable television, where product or service quality can vary widely across suppliers and over time, and where different consumers place very different valuations on various product attributes." (*Katz Analysis of Cooper* at 21.)

[53] Banning bundles entirely is not a solution. Doing so would amount to regulating prices upward and would deny consumers the benefits of efficient bundling.

[54] *Cooper on Bundling*, at 27. See, also, at 1.

56. Although Dr. Cooper correctly concludes that must-carry obligations override market forces and give broadcasters artificial advantages in competing against non-broadcast programmers for scarce channel capacity, he incorrectly implies that *a la carte* pricing would be a solution. It would not. Even under *a la carte* pricing, broadcasters would continue to have an artificial advantage obtaining cable carriage. The only remedy would be to end must-carry obligations.

XII. CONCLUSION

57. Dr. Cooper makes a number of claims in support of his call for mandatory *a la carte* pricing of cable television services. However, examination of the facts and application of economic principles demonstrate that Dr. Cooper's claims are fundamentally flawed and lack sound factual or logical foundations. Contrary to Dr. Cooper's assertions, mandatory unbundling would harm consumers by: (a) inefficiently reducing the benefits derived from existing programming; (b) raising the retail price of existing cable programming; and (c) reducing the range and quality of programming available. Mandatory programming structures are not the answer to any meaningful public policy question. Unsubstantiated claims to the contrary do not change that fact.

XIII. APPENDIX

58. A generalization of the first example in Section III.C further illustrates how wrong the proponents of mandatory unbundling are when they assert that tiers force consumers' to pay for programming they do not want. It also demonstrates the falsity of Dr. Cooper's claim that analyses of the harm of mandatory unbundling somehow rely on special properties of linear demand curves.[55]

59. Maintain the assumptions of the example in the text except that: (a) consumer demand for the two networks now has the structure described below, and (b) per-subscriber distribution costs can vary depending on whether there is *a la carte* pricing or bundling.

60. As in the first example, any given consumer values only one of the two networks, and equal numbers of consumers value each network. As noted earlier, the assumption that no consumer wishes to view programming on both networks clearly is extreme, but this is the situation in which unbundling proponents should expect unbundling to do the most to protect consumers. The market demand for each network sold *a la carte* is given by demand curve: $D_A(p)$. Observe that this demand curve can take any of a wide range of functional forms. The demand curve is the same for each network. Because any given consumer values only one of the two networks, the demand for a tier comprising both networks is $D_T(p) = 2\ D_A(p)$.

61. Now consider the cost side of the market. As before, each programming network costs a fixed amount, F, per year to create, and the cable system's construction costs are sunk. In contrast to the earlier example, the per-subscriber distribution costs can vary depending on whether there is *a la carte* pricing or bundling. These costs include the expenses of maintaining

---

55 *Cooper on Bundling* at 39.

a billing account, as well as the costs of any necessary equipment in a customer's home, such as a set-top box. When the two networks are offered on an *a la carte* basis, there is an ongoing per-subscriber distribution cost of c_A. When the two networks are offered only on a bundled basis, there is an ongoing per-subscriber distribution cost of c_B.

62. Let $p^m(c)$ denote the monopolist's profit-maximizing price under *a la carte* pricing when its marginal costs are equal to c. It is a simple mathematical fact that, in this example, the monopolist's profit-maximizing price under bundling is also $p^m(c)$ when its marginal costs are equal to c. Consequently, when $c_A = c_B$, consumers pay the same amount for a bundle of two networks that they would pay for the right to view the single network that they value watching. It is simply false to claim that bundling forces consumers to pay for channels they don't want.

63. In reality, *a la carte* sales require more sophisticated billing and more complex set-top boxes. Thus, it is more realistic to consider situations in which $c_A > c_B$. It is a well-established economic fact that, for all but certain special cases, $p^m(c_A) > p^m(c_B)$ when $c_A > c_B$.[56] In words, *a la carte* pricing will lead to consumers paying more to receive less.

64. Although the example above assumes that the creation and distribution of multi-channel video programming is monopolized, that industry structure is not essential to the finding that *a la carte* harms consumers and leads to their paying more to receive less. As the following example illustrates, one can obtain the same result in an industry with both competitive program creators and independent, competitive program distributors. All other assumptions are unchanged from the previous example.

[56] In certain special cases, $p^m(c_A) = p^m(c_B)$ even when $c_A > c_B$.

65. Suppose that there is a competitive supply of programming, so that the prospects of entry and exit drive economic profits to zero. In this case, a programmer just recovers its costs, F. Similarly, a competitive MVPD can collect no more than $ks + c_i$ from its subscribers for receiving k networks, where s is the per-subscriber fee charged to the distributor by each program creator and c_i is equal to either c_A or c_B, depending on whether networks are offered on an *a la carte* or bundled basis..

66. Under bundling, a cable operator would sell two-network packages for $2s_B + c_B$ each. The zero-profit condition for networks implies that $s_B = F/n$, where n is the number of cable subscribers. Hence, each consumer pays a total of $c_B + 2F/n$ for a bundle of two networks.

67. Under *a la carte* pricing, the outcome depends on consumer tastes:

- Suppose that everyone buys both of the two networks. Then it must be the case that a single channel costs $s_A + c_A/2$. Moreover, the zero-profit condition for networks implies that $s_A = F/n$. Hence, each consumer pays a total of $c_A + 2F/n$ for a pair of networks.
- Suppose that everyone buys only one of the two networks. Then it must be the case that a single channel costs $s_A + c_A$. Moreover, the zero-profit condition for networks implies that $s_A = F/(n/2) = 2F/n$. Programmers charge higher per-subscriber fees to system operators because the programmers have to amortize their fixed costs over smaller subscriber bases. Hence, each consumer pays a total of $c_A + 2F/n$ for a single network.

In the first outcome, consumers pay more under *a la carte* pricing to get the same programming as under bundling when $c_A > c_B$. In the second outcome, consumers pay more money under *a la carte* pricing to get access to less programming than under bundling when $c_A > c_B$. Either way, mandatory unbundling harms consumers.

XIV. ABOUT THE AUTHOR

68. Michael L. Katz is the Sarin Professor of Strategy and Leadership at the University of California, Berkeley. He holds a joint appointment in the Haas School of Business Administration and the Department of Economics. He has also served on the faculty of the Department of Economics at Princeton University. He received his A.B. from Harvard University *summa cum laude* and his doctorate from Oxford University. Both degrees are in Economics.

69. He specializes in the economics of industrial organization, which includes the study of antitrust and regulatory policies. He regularly teaches courses on microeconomics and business strategy. He is the co-author of a microeconomics textbook, and he has published numerous articles in academic journals and books. He has written academic articles on issues regarding the economics of network industries, systems markets, telecommunications policy, and antitrust enforcement. He is recognized as one of the pioneers in extending the theory of network effects to competitive settings. He is a co-editor of the *Journal of Economics and Management Strategy* and serves on the editorial board of the *California Management Review*.

70. In addition to his academic experience, he has consulted on the application of economic analysis to issues of antitrust and regulatory policy. He has served as a consultant to both the U.S. Department of Justice and the Federal Communications Commission on issues of antitrust and regulatory policy. He has served as an expert witness before state and federal courts. He has also provided expert testimony before a state regulatory commission and the U.S. Congress.

71. From January 1994 through January 1996, he served as the Chief Economist of the Commission. He participated in the formulation and analysis of policies toward all industries

under Commission jurisdiction. As Chief Economist, he oversaw both qualitative and quantitative policy analyses.

72. From September 2001 through January 2003, he served as the Deputy Assistant Attorney General for Economic Analysis at the U.S. Department of Justice. He directed a staff of approximately fifty economists conducting analyses of economic issues arising in both merger and non-merger enforcement. Their principal professional focus was on understanding and projecting the impacts of various business practices and public policy decisions on consumers' economic welfare. His title as Deputy Assistant Attorney General notwithstanding, he is not an attorney.